REVENUE ACT OF 1951

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SECOND CONGRESS

FIRST SESSION

ON

H. R. 4473

AN ACT TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

PART 3

JULY 23, 24, 25, 26, 27, 30, 31, AUGUST 1, 2, AND 3, 1951

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REVENUE ACT OF 1951

MONDAY, JULY 23, 1951

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

The committee met, pursuant to recess, at 10 a. m. in room 312, Senate Office Building, Clyde R. Hoey presiding.

Present: Senators Hoey, Millikin, Taft, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator HOEY. The committee will come to order.

Mr. G. G. Tegnell of the New York State Chamber of Commerce was to testify this morning, but he sent in a statement and asked that it be inserted in the record, so I will give that to the reporter to place in the record.

(The prepared statement of Mr. G. G. Tegnell follows:)

CHAMBER OF COMMERCE OF THE STATE OF NEW YORK,
New York 5, N. Y.

To the Members of the Finance Committee of the United States Senate:

The committee on taxation of the Chamber of Commerce of the State of New York has given careful consideration to H. R. 4473. The committee has concluded that it is such an unsatisfactory bill that it cannot be amended; and that it should be rejected by the Senate Finance Committee.

INDIVIDUAL INCOME TAX RATES NOW AT LIMIT

It is the opinion of our committee that the limit in individual income taxes has been reached and that no further increases should be made in this area.

The flat 12½-percent increase in the individual taxes proposed in H. R. 4473 is unrealistic and inequitable. It would add strong inflationary pressures through further discouragement of savings, so needed for expansion of productive facilities. It would further discourage incentives, particularly on the part of younger, ambitious persons, to work and establish new businesses of their own. It would impose tremendous new burdens on present taxpayers who are already bearing such a disproportionate share of the tax load. Any increase in this burden could have catastrophic consequences for our economy and society.

THE CORPORATE INCOME TAX

Corporation income taxes were substantially increased in the Revenue Act of 1950, and the present rates for normal and surtaxes combined are very close to the limit for this kind of taxation without serious detriment to our economy. The proposed increase of 5 percent, in the opinion of our committee, definitely raises the total past that limit, and it should be rejected.

THE EXCESS PROFITS TAX

There can be no justification for the changes in so-called excess-profits taxation as incorporated in H. R. 4473. Definite assurance was given by the House that no increases in the excess-profits tax would be made without hearings being afforded to businessmen to present their views on the various provisions of the act. The increases made by the committee in H. R. 4473, without any discussion allowed to the House, should be rejected in toto. They would add greatly to the inflationary effects inherent in this type of taxation, and they would aggravate the discriminations of the present law. If any changes are to be made in the present act, the opportunity for a reconsideration of all of the provisions of the act should be given.

EXCISE TAX INCREASES

The increases in excise taxes in H. R. 4473 fall almost entirely on a few products which are already heavily taxed. It is the opinion of this committee that it is unfair and unwise to levy heavier excise taxes on these products alone.

DOES THE FEDERAL GOVERNMENT NEED ADDITIONAL REVENUE

In his recent testimony, Treasury Secretary Synder indicated that Federal expenditures for the 1951-52 fiscal year would approximate $68.4 billion. He estimated receipts from current taxes at present rates at $58.5 billion.

In this connection it should be noted that the net receipts of the Federal Government for the first 6 months of the calendar year 1951 totaled $29.7 billion—or an annual rate of return of approximately $60 billion at the present level of economic activity.

It must be borne in mind, moreover, that the effects of the Revenue Act of 1950 and the excess profits tax bill of 1950 have not yet become fully known. Many of the provisions of these measures were not completely effective until 1951. There has not been sufficient time, therefore, to verify the expectancy of yield of these tax increases already levied.

Taking into consideration the continuing growing volume of employment, as well as increases in personal income and the rate of industrial production, there is every reason to believe that the yield of present taxes will increase substantially over the current rate of receipts.

If Secretary Snyder's estimated receipts fall as far below the actual figures as the estimate made 6 months ago for the fiscal year ending June 30, 1951, his $58.5 billion figure can be increased by $4 to $5 billion.

The Federal Government closed its books on fiscal 1950-51 with a net surplus of $3.5 billion. The actual cash surplus exceeded $6 billion.

In the opinion of the committee, the yield of present taxes at present rates, with the application of the surplus remaining from 1951, can result in sufficient revenues to balance the proposed 1952 expenditures, if reasonable and necessary economies are made. No further tax increases are necessary at this time, therefore, to maintain the Federal Government on a pay-as-you-go basis. This would appear to make it unnecessary to rush through any revenue act at this time.

THE NEED FOR FEDERAL GOVERNMENT ECONOMY

The President has urged the citizens of this country to tighten up their belts and reduce expenditures.

Our committee believes that the Federal Government should do likewise, and that a substantial reduction in the 1951-52 budget, both civilian and military, can be effected without curtailing the necessary activities of Government or the preparations for more adequate defense.

It is not necessary here to document again the need for greater economy in the operation of the Federal Government. The Members of Congress are well aware of the overwhelming demand for substantial reductions in Federal spending through elimination of unnecessary and wasteful operations and personnel. It is squarely up to Congress to effectuate the economies so urgently demanded; and we urge increased and more vigorous action to accomplish this essential goal.

TYPE OF TAX BILL TO BE LATER CONSIDERED

If it should be determined at some later date that additional Federal revenues are immediately required, our committee recommends that a consumption or retail sales tax would best serve the needs of the Treasury for such revenues. Such a tax would be immediately productive, and in addition, it would be anti-inflationary in effect in contrast to the seriously inflationary aspects of H. R. 4473.

Our committee urges, therefore, that early consideration be given by the Senate Finance Committee and by the House Ways and Means Committee, to the preparation of a consumption or retail sales tax which could be put into effect if, as and when needed.

Respectfully submitted.

PERCIVAL F. BRUNDAGE, *Chairman,*
DUNCAN G. HARRIS,
CHARLES A. HOYLER,
EDMOND E. LINCOLN,
CEDRIC A. MAJOR,
HENRY G. WOOD,
Of the Committee on Taxation.
ROBERT L. HAMILL, *President,*
GEORGE H. COPPERS,
Chairman, Executive Committee.

Attest:

B. COLWELL DAVIS, Jr.,
Executive Secretary.

NEW YORK, *July 18, 1951.*

Senator HOEY. The first witness is Joseph H. Ball.

Senator, we are glad to have you come and testify. Give your name and identify who you represent.

STATEMENT OF HON. JOSEPH H. BALL, VICE PRESIDENT, ASSOCIATION OF AMERICAN SHIP OWNERS

Mr. BALL. My name is Joseph H. Ball, vice president of the Association of American Ship Owners, which has offices at 1713 K Street NW., in Washington, D. C., and 90 Broad Street, New York.

The association comprises a number of old and well-established shipping companies, none of which have ever been subsidized. They operate in both the foreign and domestic trades.

Senator MILLIKIN. It is good to see you, Senator.

Mr. BALL. Thank you, sir.

Mr. Chairman, I understand that time is limited. I came prepared to put this statement in the record, and I wish to make an oral statement.

Senator HOEY. It will be entirely agreeable, if you desire to insert it in the record and make an oral statement.

I might say, as the supreme court of my State said to me the first time I appeared before it and the chief justice who was presiding—I asked how much time I had and he said 30 minutes. He said, "I understand the court will not hold it against you if you do not use it all." So the committee will pursue the very same policy.

Mr. BALL. Mr. Chairman, we are interested in an amendment to the excess profits tax law and we are urging the Senate Finance Committee in its consideration of H. R. 4473, to include a relief provision for unsubsidized companies which have deposited over $200,000,000 in construction reserve funds, established under section 511 of the Merchant Marine Act of 1936.

With the increases in tax rates that have taken place since 1946 and 1947, when most of these deposits were made, the conditions under which they were made have changed materially for the worse for the people who made the deposits.

I am sure that this committee will recall that when the excess profits tax bill was under consideration in the Senate in 1950 the Senate did adopt an amendment giving relief to shipowners who had deposited funds in both section 511 funds and in section 607 funds.

There are two opportunities for tax benefits under section 607 but they apply only for the subsidized shipping companies, those receiving an operating differential subsidy, of which there are some 13 companies.

However, the Senate amendment to the excess profits tax bill was deleted in conference. The House conferees, as I understand it, insisted that the Treasury needed more time to study the proposal and comment on it.

We are not concerning ourselves at this time with section 607 funds. They are quite a different problem from the 511 funds because they are in effect only as long as an operating differential subsidy contract is in effect. The 511 funds are open to any shipping company, whether it is subsidized or unsubsidized but, in fact, were used only by the unsubsidized lines because the so-called tax benefits under section 607 were much greater than under 511.

Section 511 is somewhat comparable to section 112 (f) of the Internal Revenue Code dealing with involuntary conversions.

The section provides that if a shipowner's vessel is lost or sold, and the proceeds of the purchase or the requisition of the vessel are deposited in a construction reserve fund, which is administered under rules adopted jointly by the Treasury and the Department of Commerce, that any capital gains resulting from that loss or purchase are not recognized for tax purposes as long as the funds are used within a specified time, which is 2 years with a permissible extension for 2 more years, to purchase or build a new vessel.

The purpose of section 511, of course, was to offer shipowners an incentive to convert their capital gains into ships as rapidly as they were realized. The incentive was the fact that they could use the 25 percent tax they otherwise would pay to increase their capital investment, and pay that back in lower depreciation over the life of the vessel.

The entire gains were not recognized in the tax basis of the vessel which meant that, for instance, if a shipowner used a million dollars in capital gains in 511 funds to buy a ship, the tax basis of the ship was zero, so that he could take no depreciation over the life of the vessel and, in effect, paid the 25 percent capital gains tax, if the vessel earned its depreciation over its life, at the rate of 38 percent, the combined normal and surtax income rate.

That was a fairly high price to pay for the immediate use of the capital, since the owner always was liable for capital gains tax when he disposed of the vessel if he realized any gain.

When the combined corporate normal and surtax rate was 38 percent, which it was in 1946 and 1947 that was one thing. But today the shipowner is paying a pretty high price for taking advantage of that section, as this Government wanted him to, because the combined normal and surtax rate is now 47 percent. The pending bill proposes to increase it 2 percent, and we have an excess profits tax of 30 percent in addition, and of course, these vessels bought with 511 funds do not enter into the owner's invested capital base for the excess profits tax, so he is caught again there and he is subject to the over-all tax rate now of 62 percent, which the pending bill proposes to increase to 70 percent, so that he is going to pay back this 25 percent capital gains tax which was deferred at a rate nearly three times as high. That is a very different situation from the 38 percent rate on which he made his calculations when he originally put the funds into the 511 construction reserve fund.

Actually, of course, the incentive did work very well. The figures show that by the end of 1949 shipowners had invested $264 million plus in the 511 funds, and had used $222 million of it to buy ships.

There is an actual example in my statement showing the effect of the reduction in tax base, resulting from the application of 511 on a shipowner purchasing a vessel out of section 511 funds with the taxes of a shipowner who bought the same priced vessel out of non-511 funds, free funds, in other words.

The comparison shows that as of today, if they are both in the 30 percent excess-profits tax rate, the shipowner who used 511 pays $87,780 taxes on $114,000 of earnings, whereas the shipowner who did not use it pays $30,080 on the same earnings because he can take the 5 percent-a-year depreciation, which is the normal depreciation, plus the fact that he has a larger invested capital base on which to compute his excess-profits earnings.

We have submitted in the brief two alternative proposals to correct this. One is an amendment to the excess-profits tax directly; the other would add a new subsection to section 511 of the Merchant Marine Act. Both would have exactly the same effect. They would permit a shipowner who had invested funds in a construction reserve fund under section 511 one option in his 1951 tax year to go back and unwind the whole transaction, to pay the 25 percent capital-gains tax which he did not pay, less a credit for the higher income and excess-profits taxes he has paid in the intervening years due to the fact that he took advantage of section 511. The option could be exercised only once; it would be irrevocable once made.

I think that it has one advantage. I understand that the Treasury prefers that the tax basis of a corporation for both the normal and surtax and the excess-profits tax be the same; in other words, that you do not have one capital base or depreciation base for the normal tax, and a different one for the excess-profits tax.

The amendment which the Senate adopted last year would have applied only to excess profits and a vessel owner who took advantage of it would have had one base for the normal income tax and a different one for the excess-profits tax.

The proposal we make would give him the same tax valuation for both the normal and the excess-profits tax.

The language we propose, and we are not too insistent on this point, does not provide for payment of any interest either on the capital gains tax which the shipowner would pay or on the refund of income taxes and excess profits taxes with which the Government would credit him.

We did not include interest because under section 511 as it now stands if a shipowner has moneys still on deposit in his construction reserve fund and has not put it into ships he can withdraw it now, pay the 25 percent capital gains tax without interest, and have the capital free.

It seemed a little unfair to penalize, by charging interest, the shipowner who had deposited the funds and used them for the purpose intended, which was to buy new ships.

I think that is about all I have to say, Mr. Chairman. I appreciate very much this opportunity to present the problem, and I hope that we can get the Treasury views on it this time.

Senator HOEY. Do you have any questions at this time?

Senator MILLIKIN. Senator Ball, have you talked to Mr. Stam on it?

Mr. BALL. I have not talked with him recently. I talked with him last year, when this-----

Senator MILLIKIN. May I suggest that you get in touch with him and have a talk with him so that we can bring the whole matter up to date from the technical standpoint.

Mr. BALL. I will do that, Senator.

Senator HOEY. Thank you very much, Senator.

Mr. BALL. Thank you, Mr. Chairman.

(The prepared statement of Joseph H. Ball follows:)

STATEMENT OF JOSEPH H. BALL, VICE PRESIDENT AND WASHINGTON REPRESENTATIVE OF THE ASSOCIATION OF AMERICAN SHIP OWNERS

My name is Joseph H. Ball. I am vice president of the Association of American Ship Owners, which has offices at 1713 K Street NW., Washington, and 90 Broad Street, New York. Our association comprises some of the oldest and best-established shipping companies operating under the American flag in both the domestic and foreign trades. None of them has received any subsidy from the Federal Government under the Merchant Marine Act of 1936. A list of the member companies of the association is attached as exhibit A.

On behalf of the association, I respectfully urge the Senate Finance Committee, in its consideration of the pending revenue bill, H. R. 4473, to include a relief provision for unsubsidized shipping companies which have deposited upward of $200 million in construction reserve funds set up under section 511 of the Merchant Marine Act, 1936, and have constructed vessels with the funds so deposited. These companies are penalized severely, as compared with companies which made no such deposits, as a result of the increases in corporation normal and surtax income rates and enactment of the excess-profits tax.

Members of this committee will recall that when the excess-profits tax was under consideration in 1950, the Senate included in the bill it passed a provision granting relief both to shipowners with section 511 funds and to subsidized ship operators who had made deposits of both capital gains and earnings in funds authorized by section 607 of the Merchant Marine Act, 1936. The entire provision was deleted from the bill in conference, the House conferees contending that the Treasury had not had sufficient time to study and report on the proposed language. Because of the very substantial differences in section 511 and section 607 funds, our association is not attempting to deal with the problems of section 607 funds in its current presentation, but is confining itself entirely to the tax problems faced by the unsubsidized ship operators who utilized the provisions of section 511 of the Merchant Marine Act.

Section 511 of the Merchant Marine Act is comparable to section 112 (f) of the Internal Revenue Code dealing with involuntary conversions. Ordinarily if a shipowner's vessel is lost, sold, or requisitioned, and the insurance proceeds on account of the lost, or the proceeds from the purchase or requisition exceed the depreciated tax basis of the vessel, a taxable gain would be recognized and taxed at the maximum 25-percent rate. Section 511 of the Merchant Marine Act, 1936, defers recognition of this gain if the shipowner deposits such proceeds in a construction reserve fund, which is regulated jointly by the Secretary of the Treasury and the Secretary of Commerce. Nonrecognition of the gain ceases to apply, however, unless the funds deposited are obligated within a designated period of time to purchase or construct a new vessel (the period is 2 years initially with extensions up to 2 years additional at the discretion of the Secretary of Commerce). If the funds are obligated within the designated period, the tax basis of the new vessel so purchased or constructed is reduced by the entire amount of the unrecognized gains used in acquiring the vessel. If the deposited proceeds are not obligated within the designated period to purchase or construct a new vessel or vessels, the original gain is recognized and included in the shipowner's gross income for the year in which it was realized, and the deferred tax then becomes due. The same result likewise follows if the shipowner withdraws gains on deposit for any purpose other than acquisition of a new vessel. In neither case, however, is interest payable on the deferred tax.

The purpose of section 511 of the 1936 act obviously was to encourage the reinvestment of capital gains in shipping enterprises. The incentive offered was deferment of the 25-percent tax on such gains for as long as the funds remained invested in ships. That the incentive worked reasonably well is indicated by the fact that through October 31, 1949, unsubsidized shipping companies had deposited a total of $264,512,540 in section 511 construction reserve funds and had obligated $222,582,483 of such funds for purchase of new vessels (table XXII-D, p. 328, S. Rept. 2494, Committee on Interstate and Foreign Commerce, 81st Cong., 2d sess.).

Shipowners who made these deposits of capital gains and used them to acquire ships are finding today that the price they thought they were paying in using section 511 has almost gone through the roof and appears to be still rising. When the combined normal and surtax rate on corporations was 38 percent the price tag was high enough. In return for deferment of the 25-percent capital-gains tax, the shipowner who used his deposits to acquire a new vessel paid tax at the rate of 38 percent a year on depreciation he might otherwise have taken on the vessel that he acquired. That is to say, if he had not used section 511 he would have gotten the benefit of depreciation on the full cost basis, whereas by using section 511 he gave up the benefit of depreciation on the portion of the cost that was financed with unrecognized gain. Hence, the original price to the shipowner of using section 511 was the difference between 25 percent of the gain and 38 percent of the gain—the latter spread over the vessel's useful life.

However, with the combined normal and surtax rate on corporations now increased to 47 percent, and the pending bill proposing to increase it to 52 percent, with an excess-profits tax rate of 30 percent in addition, and the pending bill proposing to reduce the credit to 75 percent of normal profits and to increase the over-all ceiling to 70 percent, the cost of the incentive to buy ships in section 511 has become terrifically high. For the privilege of having his original capital-gains tax deferred (not excused, since whenever the vessel is liquidated the tax once again becomes payable), the shipowner who acquired a new vessel with section 511 funds is now confronted with a possible tax liability on the depreciation he cannot deduct at a rate almost 3 times that of the 25-percent capital-gains tax rate. This situation, which no one in 1946 or 1947 could have foreseen, works a very serious inequity on the shipowner who took advantage of section 511, as his Government wanted him to do, as compared to the shipowner who did not utilize section 511 at all.

The effect of the reduction in tax basis provided by section 511 can perhaps best be illustrated by comparing the taxes of a shipowner purchasing a vessel out of section 511 funds with the taxes of a shipowner purchasing a vessel out of nondeposited funds. For this illustration let us assume that shipowner A lost a World War I vessel in World War II after it had been fully depreciated for tax purposes and that he received $1 million of insurance proceeds on account of his loss. Let us further assume that, instead of paying the $250,000 tax gains tax thereon, he deposited all of the proceeds in a section 511 construction reserve fund and on January 1, 1947, withdrew the $1 million so deposited in order to purchase a new vessel. By way of comparison, let us assume that shipowner B purchased a similar vessel on the same date out of $1 million of nondeposited funds.

Because shipowner A's vessel was purchased entirely out of nonrecognized gains, section 511 (d) requires that his vessel's tax basis be zero, whereas the basis of shipowner B's vessel would be the full $1 million. If the depreciable life of the vessels is deemed to be 20 years, then shipowner B is entitled to an annual depreciation allowance of $50,000, being 5 percent of his $1 million basis, whereas shipowner A's annual depreciation allowance, being 5 percent of his zero basis, is also zero. In each of the years when corporate tax rates were 38 percent, shipowner A's taxes would therefore have been $19,000 (38 percent of $50,000) more than shipowner B's taxes. In the course of 20 years with taxes at the same 38-percent rate, shipowner A would pay, in lieu of his original $250,000 capital-gains tax liability, $380,000 more in income taxes than shipowner B.

When shipowner B purchased his vessel in 1947, he could not foresee that excess-profits taxes would be enacted and that he might in fact be obligating himself to pay his deferred 25-percent tax at rates as high as 70 percent and, further, that he would be denied any recognition for his investment in his vessel if his excess-profits taxes were computed on an invested-capital basis.

The wide disparity in taxes payable by shipowner A and shipowner B under the new combined normal and surtax rate and the new Excess Profits Tax Act can be seen from the attached schedule, where it is assumed that both shipowner A and shipowner B are in the 8-percent invested capital credit bracket and that their top earnings are subject to the 30-percent excess-profits tax. It is further assumed that the earnings before taxes and depreciation of both shipowner A and B are $114,000 (this happens to be the amount of income which fully absorbs shipowner B's invested capital credit without subjecting him to an excess-profits tax). With these earnings shipowner A's taxes are $87,780, or nearly 3 times as much as shipowner B's taxes of $30,080. Shipowner A's taxes actually amount to 37 percent more than shipowner B's normal tax net income.

Comparisons of income taxes (computed on an invested capital basis) and net return on capital investment attributable to purchase of $1 million vessel in 1947 (A) out of sec. 511 deposited gains and (B) out of nondeposited corporate funds.

	Shipowner A	Shipowner B
1. Vessel cost, Jan. 1, 1947	$1,000,000	$1,000,000
2. Adjusted basis, Jan. 1, 1947	0	1,000,000
3. Less depreciation (5 percent 1947-50)	0	200,000
4. Adjusted basis, Jan. 1, 1951	0	800,000
5. Net income before depreciation, 1951	114,000	114,000
6. Less depreciation	0	50,000
7. Normal tax net income	114,000	64,000
8. Less invested capital credit (8 percent of line 4)	0	64,000
9. Excess-profits net income	114,000	0
10. Normal and surtax taxes (47 percent of line 7)	53,580	30,080
11. Excess-profits tax (30 percent of line 9)	34,200	0
12. Total taxes	87,780	30,080

Our association suggests two alternative methods of curing this inequity and proposed drafts are attached as exhibits B and C. Both drafts would achieve the same result: permit the shipowner with section 511 funds or vessels acquired with such funds in effect to go back and reverse his original decision to deposit capital gains in section 511 funds rather than pay the capital-gains tax of 25 percent. The exhibit B draft would accomplish this by adding a new section to chapter 1 of the Internal Revenue Code (excess-profits tax), while the exhibit C draft would do it by adding a new subsection (o) to section 511 of the Merchant Marine Act of 1936. The result in either case would be identical.

A shipowner with section 511 funds would be given one irrevocable option, in the 1951 taxable year, to restore the full tax basis of vessels purchased with such funds by paying the 25-percent capital-gains tax minus the additional income and excess-profits taxes he has paid in the years intervening since deposit of the funds because of the lower tax basis of his enterprise. Thus, under the example cited above, shipowner A could increase the tax basis of his vessel to that of shipowner B's vessel upon payment of $250,000 capital-gains tax. His income taxes, however, would be recomputed for the intervening years and he would be credited with the amount of increased income taxes paid by reason of section 511. In the example used above, shipowner A would pay $250,000 (the 25-percent capital-gains tax on $1 million) less $19,000 for each of the years 1947, 1948, and 1949, and less $29,000 for 1950 ($21,500 in normal and surtax taxes and $7,500 in excess-profits tax), or a total of $86,000, making the balance due on his capital-gains tax $164,000.

This proposal we believe would be more acceptable to the Treasury than the amendment included in the excess profits tax bill last year by the Senate for two reasons: (1) Vessels of a shipowner exercising the option granted would have the same tax basis for both normal and surtax taxes and for excess-profits tax, whereas the language proposed last year would have provided one basis for excess-profits taxes and a different one for normal and surtax taxes. It is our understanding the Treasury Department strongly favors having the tax basis of a corporation be the same for both normal and surtax and excess-profits tax. (2) Enactment of this amendment and its use by shipowners would produce substantial additional revenues to the Government in the current fiscal year and reduce them only slightly in future years while at the same time establishing tax parity in future years between shipowners who did use section 511 and those who did not.

Our proposed amendment, in either form, would require no payment of interest, either by the shipowner on the deferred capital gains tax, or by the Government on the credits or refunds of extra income and excess-profits taxes paid in the intervening years by reason of section 511. Interest was waived in the proposed drafts primarily because under section 511 as it now stands, a corporation which still has uncommitted capital gains on deposit in section 511 funds may withdraw such funds and use them as he wishes by payment of the 25-percent capital gains tax, without any interest. To charge interest to the shipowner who had complied with the intent of the law and invested his section 511 funds in ships would be to discriminate against him and in favor of the shipowner who failed to invest the funds in ships.

Exhibit A

Members of Association of American Ship Owners

American-Hawaiian Steamship Co., New York, N. Y.
American-Hawaiian Steamship Co. (Delaware), New York, N. Y.
A. H. Bull Steamship Co., New York, N. Y.
Baltimore Insualr Line, Inc., New York, N. Y.
California Eastern Lines, Vancouver, Wash.
Eastern Steamship Lines, Inc., Boston, Mass.
Luckenbach Steamship Co., Inc., New York, N. Y.
Luckenbach Gulf Steamship Co., Inc., New York, N. Y.
Pacific-Atlantic Steamship Co., Vancouver, Wash.
Seatrain Lines, Inc., New York, N. Y
Shepard Steamship Co., Boston, Mass.
States Marine Corp., New York, N. Y.
States Marine Corp. of Delaware, New York, N. Y.
States Steamship Co., Vancouver, Wash.

Exhibit B

Amend H. R. 4473 by inserting at the proper place in the bill a new section reading as follows:

"Subchapter D (excess profits tax) of chapter 1 of the Internal Revenue Code is amended by inserting after section 458 a new section reading as follows:

"'Sec. 459. Corporations Which Have Established Construction Reserve Funds Under Section 511 of the Merchant Marine Act, 1936

"'(a) Election To Treat Certain Gains as Taxable.—Any taxpayer which, on the date of the enactment of this section—

"'(1) has on deposit in a construction reserve fund established under section 511 of the Merchant Marine Act, 1936, as amended, funds representing net proceeds of the sale, or the net indemnities with respect to the actual or constructive total loss, of any one or more vessels; or

"'(2) owns one or more vessels that were constructed or acquired in whole or in part from withdrawals (from a construction reserve fund established under section 511 of the Merchant Marine Act, 1936, as amended) of deposits representing gains, that by reason of section 511 (c) of such Act, was not recognized, may elect, in its return for its taxable year beginning in 1951 (or in the event more than one taxable year of the taxpayer begins in 1951, in its return for its last taxable year so beginning) to treat the gains from such sales and the gains from the indemnities with respect to such losses as having been gains that were recognized when they were realized and to adjust its liability for income- and excess-profits taxes for the taxable year and all prior taxable years accordingly. Such election shall also apply to all subsequent taxable years to which this subchapter is applicable and, in the case of all taxable years to which this subchapter is applicable and all prior taxable years, shall be irrevocable when once made.

"'(b) Method of Adjustment.—If an adjustment specified in subsection (a) is, with respect to any taxable year, prevented, on the date of the election by the taxpayer under subsection (a), or within two years from such date, by any provision or rule of law (other than this subsection and other than section 3761, relating to compromises, (1) such adjustment shall nevertheless be made, (2) the amount of the adjustment shall be limited to the increase or decrease in the income and excess profits taxes previously determined for such taxable year, which results solely from the effect of subsection (a), and (3) such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if on the date of such election two years remain before the expiration of the period of limitation upon the assessment or the filing of claim for refund for such taxable year except that no interest shall be held or considered to have accrued with respect to any amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency, and no interest shall be allowed or paid on any amount to be refunded or credited under this paragraph in the same manner as if it were an overpayment, for any period prior to the date of the election by the taxpayer under subsection (a). The income- and excess-profits taxes previously determined shall be ascertained in accordance with section 452 (d). The amount to be assessed and collected under this subsection in the same manner as if it were a deficiency or to be refunded or credited in the same manner as if it were an overpayment, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of subsection (a). Such amount, if paid, shall not be recovered by a claim or suit for refund, or suit for erroneous refund, based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of subsection (a).

" '(c) DEFINITION.—As used in this section the term "income and excess profits taxes" means the tax imposed by this chapter, subchapter A of chapter 2, subchapter B of chapter 2, and subchapter E of chapter 2, for taxable years beginning after December 31, 1939.' "

EXHIBIT C

Amend H. R. 4473 by inserting at the proper place in the bill a new section reading as follows:

"Section 511 of the Merchant Marine Act, 1936, as amended (relating to construction reserve funds) is amended by inserting at the end thereof a new subsection reading as follows:

" '( ) (1) Any taxpayer which, on the date of the enactment of this subsection—

" '(A) has on deposit in a construction reserve fund established under this section funds representing net proceeds of the sale, or the net indemnities with respect to the actual or constructive total loss, of any one or more vessels; or

" '(B) owns one or more vessels that were constructed or acquired in whole or in part from withdrawals (from a construction reserve fund established under this section) of deposits representing gains that, by reason of subsection (c) of this section, were not recognized, may elect, in its income-tax return for its taxable year beginning in 1951 (or in the event more than one taxable year of the taxpayer begins in 1951, in its return for its last taxable year so beginning) to treat the gains from such sales and the gains from the indemnities with respect to such losses as having been gains that were recognized when they were realized and to adjust its liability for income- and excess-profits taxes for the taxable year and all prior taxable years accordingly. Such election shall also apply to all subsequent taxable years to which subchapter D of chapter 1 of the Internal Revenue Code is applicable, and, in the case of all taxable years to which such subchapter is applicable and all prior taxable years, shall be irrevocable when once made.

" '(2) If an adjustment specified in paragraph (1) of this subsection is, with respect to any taxable year, prevented, on the date of the election by the taxpayer under paragraph (1), or within two years from such date, by any provision or rule of law (other than this subsection and other than section 3761 of the Internal Revenue Code, relating to compromises), (A) such adjustment shall nevertheless be made, (B) the amount of the adjustment shall be limited to the increase or decrease in the income and excess profits taxes previously determined for such taxable year, which results solely from the effect of paragraph (1), and (C) such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if on the date of such election two years remain before the expiration of the period of limitation upon the assessment or the filing of claim for refund for such taxable year, except that no interest shall be held or considered to have accrued with respect to any amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency, and no interest shall be allowed or paid on any amount to be refunded or credited under this paragraph in the same manner as if it were an overpayment, for any period prior to the date of the election by the taxpayer under paragraph (1). The income and excess-profits taxes previously determined shall be ascertained in accordance with section 452 (d) of the Internal Revenue Code. The amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency or to be refunded or credited in the same manner as if it were an overpayment, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (1). Such amount, if paid, shall not be recovered by a claim or suit for refund, or suit for erroneous refund, based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (1).

"'(3) As used in this subsection the term "income and excess profits taxes" means the tax imposed by chapter 1, subchapter A of chapter 2, subchapter B of chapter 2, and subchapter E of chapter 2 of the Internal Revenue Code, for taxable years beginning after December 31, 1939.'"

Senator HOEY. Our next witness is Mr. Ellsworth C. Alvord. Please have a seat.

I will say, Mr. Alvord, that the committee has allotted 15 minutes to you, and if you will bring your statement within that time, we would appreciate it. We will put the full statement in the record and you can make such statement as you would like.

STATEMENT OF ELLSWORTH C. ALVORD, CHAIRMAN, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. ALVORD. I would like to place my written statement in the record, Mr. Chairman. I have one in respect to the general policies to the bill, which I will give to the reporter, and I also have an unmimeographed set of so-called technical administrative amendments which I would like to give to the reporter, to be included in the record.

Senator HOEY. They will be included in the record.

Give your name, please.

Mr. ALVORD. Mr. Chairman, my name is Ellsworth C. Alvord.

Senator HOEY. And your connection?

Mr. ALVORD. I am chairman of the committee on Federal finance of the United States Chamber of Commerce and I appear and present the views of the United States Chamber of Commerce as adopted by our committee.

I am a bearer of very good news for the committee, and in contrast and conversely, I am the bearer of very bad news.

The good news I have for you is that you do not need additional revenues to balance your 1952 budget. Many of the statistics which have been presented to you, are not quite current.

On the basis of the official estimates of expenditures for fiscal 1952 you will spend about $68 billion.

On the basis of Mr. Stam's most recent estimate of revenues you will raise $61,000,000,000. That leaves an apparent deficit of $7 billion.

The $68 billion estimate of expenditures does not take into consideration any of the proposed reductions in expenditures. It contains, as you know, a good many items of proposed expenditures for legislation which has not yet passed, and which I think probably will be not passed, and it contains no cuts in any of the requests for expenditures.

It seems quite probable, at least we sincerely hope—that you gentlemen will cut the proposed $68 billion expenditures by at least $10 billion; $5 billion are easy, $7 billion is a little more difficult, $10 billion is tough; but could be done.

Senator MILLIKIN. Mr. Alvord, it is not going to be done; let us be realistic.

Mr. ALVORD. How much will be done, Senator?

Senator MILLIKIN. Well, I think you might take a couple of billion off of foreign aid, foreign economic assistance, but when you aggregate the other things there can still be some, but it is not going to reach the magnitude of 7 or 10 billion dollars.

Mr. ALVORD. With respect to the 10 I certainly agree.

Senator MILLIKIN. Let us agree that it should be done, let us agree that it ought to be done, but we are talking very practical business here——

Mr. ALVORD. That is very true, sir.

Senator MILLIKIN. And when you talk about a cut of $7 billion or as much as $10 billion, it just is not going to happen.

Mr. ALVORD. Well, let me come down then, Senator,——

Senator MILLIKIN. That is my own notion. Maybe others will feel differently.

Mr. ALVORD. Yes, sir.

That is a very realistic approach, and I also attempt to have a realistic approach.

The most moderate estimate by the advocates in Congress of economy is that they expected to attain at least a $5 billion cut; that would include $2 billion on foreign aid, and a scattered couple of billion, which is already in existing appropriations and another billion which could easily be picked up.

Senator TAFT. Foreign aid, just to begin with, however, and I have not seen the actual estimate, but my impression is that about $8½ billion were requested; the actual expenditures are only about $4½ billion, so if you cut the program in half I do not think you will save over $2 billion and I do not think you will ever do that.

Now, the $8½ he cut, but when it comes to cutting the $4½ billion of actual expenditures, I just do not know how it can be done. Maybe a half billion dollars or so could be cut off it, and that is one of the main sources that people are looking to for savings.

That is one discouraging factor. I am not sure about it, because I have not the entire thing broken down yet. We will know more about that this week.

Mr. ALVORD. I think you will find, Senator, that the estimated expenditure for foreign aid, including military, is about $7 billion for 1952.

Senator TAFT. That is what I was not sure of.

Mr. ALVORD. And I am quite sure you can knock $2 billion off that without a great deal of difficulty and without any harm, and possibly a great deal of good.

Senator TAFT. I do not think that they will be able to spend as much as 6 or 7 billion dollars. I do not think that they are able to spend it even if it is appropriated in this fiscal year.

Mr. ALVORD. In fiscal 1952. I think that is very possibly true, and that is one of the reasons I say why the current estimate of expenditures of $68 billion is high, even without economies.

I think, and I would strongly urge the committee to ask Mr. Stam to prepare new estimates of revenues—my own guess is that the $61 billion, which I think was about 3½ months ago, is low by at least $2 billion so that if you knock $5 billion off expenditures, it will bring you down to $63 billion, and if you increase receipts by $2 billion, it gives a precisely balanced budget on the basis of budgetary principles. In no event can we have a cash deficit in 1952.

Now, I think my position in that respect is supported by the members of the committee who are concerned about 1953. Consequently, I suggest that you defer action on the present bill until we know more about 1953, and until we know more about what can be done with respect to expenditures.

The only estimates I have seen on 1953 are that the expenditures may run 85, 90, 95 billion dollars. It was not long ago that I heard a rather wild estimate, I thought at the time, that the expenditures in 1953 might approach $125 billion.

Well, gentlemen, any such level of expenditures simply cannot be financed through taxes, but if expenditures are going up, it seems to me that it would be the wise thing for Congress at the present time, after having studied what the revenue needs will be, to write a tax bill for 1953 based on probable expenditures and probable receipts for 1953.

It is much too early now to have any estimate at all for 1953 on which revenue legislation should be based.

Senator TAFT. I noticed, however, that up to date during this month we have got a deficit of a billion dollars already in July, which compares to two or three hundred million dollars a year ago.

Mr. ALVORD. You will find that is always so, Senator, in July.

Senator TAFT. No, as compared to two or three hundred million a year ago so this year we are $700 million behind in 1 month from what we were last year.

Mr. ALVORD. You see—bear in mind that June 15 payments come into fiscal 1951, all of which contributed to the $3½ billion surplus for 1951.

The month of July has virtually no receipts whatsoever, except on accumulation of the witholding tax provisions and the accumulation of excise tax collections; but big collections will not be until September, so that July and August invariably run at a deficit even in the days of balanced budgets.

Now, the Secretary, as you will recall, before the House Committee on Ways and Means estimated a $16½ billion deficit for 1952.

That was last January. He proposed a $10 billion quickie bill.

Well, on the basis of present estimates there will be no $16½ billion deficit. There will be no $10 billion deficit. There need be no deficit whatsoever. Consequently there is no hurry with respect to pending legislation, and there is no necessity for making any of it retroactive.

The best suggestion I can make, the best advice I can give this committee and the Committee on Ways and Means at the present time is to begin to study all of the elements which are giving rise to this inflation which we are here talking about and which we hear talked about a great deal, and which should be seriously feared. Study our debt policies, study our monetary policies, study our spending policies and study our tax policies from the point of view of inflation, and I think you will come out with a different legislative proposal from any that I have now seen.

Senator MILLIKIN. Studying the inflationary policies, we have got to assume under the various estimates that are before us that there would be no further inflation.

Mr. ALVORD. No, sir.

Senator MILLIKIN. Yes, sir.

Mr. ALVORD. No; quite the contrary, Senator. I would adopt policies—under our present policy we cannot help but have additional inflation.

Senator MILLIKIN. Well, that is exactly what I am talking about. This committee does not have control over the matters that you are discussing.

We are assuming now that there will be no further substantial inflation in the estimates that we are working on.

Mr. ALVORD. In the estimates. Yes, sir.

Senator MILLIKIN. That is a part of the military program assumptions, which is that there will be no further substantial inflation. If you do have any further substantial inflation, obviously, your expenditures are going to rise.

Mr. ALVORD. And your revenue is going to rise, Senator.

Senator MILLIKIN. And your revenue will rise. But whether your revenue rises proportionately to the expenditures over a given period of time is something else again.

Mr. ALVORD. Of course, it depends on the level that your expenditures reach.

Senator MILLIKIN. Yes.

Mr. ALVORD. But if expenditures for 1952 remain at $68 billion, then the only effect on 1952 can be an increase in revenue.

Do you realize our national income is now running at the rate of almost $270 billion?

Senator MILLIKIN. I think that is well realized by this committee. These various matters that you so vehemently ask us to have studied, we have not neglected to study.

Mr. ALVORD. I appreciate that you have not neglected them.

Senator MILLIKIN. We have quite thoroughly considered it. We are doing as much as we can do about it in our jurisdiction.

Mr. ALVORD. All these policies that I have suggested, Senator, are within your jurisdiction.

Senator MILLIKIN. Yes, sir.

Mr. ALVORD. And I think it is highly important to begin to stop inflation at the source.

For example, I do not think that the citizens of Kansas City prayed for rain or employed rain makers in order to stop that flood; and that is precisely what Congress is doing. More money is being poured into the inflationary stream than can possibly be taken away. A study of those policies, I am sure, will lead to that necessary conclusion.

Senator MILLIKIN. We have got a job of trying to carry on a pay-as-you-go system as long as we can do it, and you have been a strong advocate of that. We have got to do the best we can with the various estimates before us, trying to figure on expenditures, "guesstimates," if you wish; you always have "guesstimates" as to revenue.

We have got to take all of those into consideration and, as an individual, I suggest to you there will be a tax bill. I suggest to you that it may be somewhat less than \$7½ billion but I suggest that there will be one. I doubt whether you can marshal much opinion that there will not be one, so we are dealing now with the practical question of where to put it. What do you suggest on that?

Mr. ALVORD. The fact that there will be a tax bill, I do not deny, Senator, but my point is, you do not need it for 1952; consequently, you can take adequate time in order to prepare whatever adequate revenue is necessary, taking all the matters into account necessary for 1953, and make the taxes apply only as to their future effect.

Senator MILLIKIN. That raises the question as to how we are going to tax for 1953, with a possible deficit of 20 to 30 billion dollars, and that raises the question of whether you tax in one fell swoop for fiscal 1953 or whether, perhaps, an easier approach to the shock of 1953 is preferable.

Mr. ALVORD. That is very true, sir. It is utterly impossible——

Senator MILLIKIN. If you happen by chance to be wrong, if we had no tax bill to cover fiscal 1952, and if we did have a deficit in fiscal 1952 of 5, 6, or 7 billion dollars, then you add to the shock of making that good in 1953 when you are bound to have a deficit of from 20 to 30 billion, and we might not be exactly acting in the wisest possible way.

Mr. ALVORD. I am not quite so sure of that, Senator, because there is no chance of a cash deficit in 1952, even if you do not change estimates at all.

Senator MILLIKIN. Well, I wish I could feel your own assurance on the subject.

Mr. ALVORD. I can assure you that I will not be \$16½ billion over, and I assure you I will not be \$7.6 billion over both current estimates of the Secretary of the Treasury.

I am using the 61 and 68 billion dollars as your own official estimates. I think \$61 billion is low, and I suggest that Mr. Stam prepare new ones.

This national income figure is going up terrifically.

Senator MILLIKIN. I think that is a good idea, and I imagine that Mr. Stam will give us an informal on that before we finish here.

Mr. ALVORD. So that the points that you make, Senator, I am in entire agreement with. I think that the thing for this committee to do is to begin to consider some sound tax policies for 1953.

Senator MILLIKIN. That is what we are doing.

Mr. ALVORD. Now, if you do that, then——

Senator MILLIKIN. And it is a very gloomy picture.

Mr. ALVORD. It is a very gloomy picture. It is bad news I am giving you.

Senator MILLIKIN. Well, we knew that before you gave it to us.

Mr. ALVORD. As of today I know of no statistics you can base anything for 1953 on except on the best "guesstimates" that we can make and I think that is an excellent word, Senator, on the best "guesstimates" that we can make, that there will be a deficit in 1953.

But let us approach that proposed deficit from a common sense point of view. Regardless of your economies for 1952 you can still have economies in 1953. We are spending, presently, much more than we can afford to spend, much more than is necessary to spend.

Senator MILLIKIN. I am in entire agreement with you on that.

Mr. ALVORD. Consequently, for 1953 you must simply get your spending policies under control and get down to the basis of what is absolutely necessary.

Senator MILLIKIN. If that were correct, this committee does not control that end of the business.

Mr. ALVORD. That is true, Senator, but you are Members of the Senate, as well as members of the Finance Committee, and I think that one of the best ways to control spending, Senator, is to say to the administration, in effect—you cannot say quite this—you get no more money than this.

"Now, you bring your own spending within that amount if you possibly can, but you get no more money than this."

Pay-as-you-go on a basis of a 20 or 25 or 30 or 35 billion dollar deficit, Senator, is utterly impossible, and I have never advocated pay-as-you-go so long as we were throwing dollars down the rat hole, as we have been doing for years.

I would plug the rat hole first. Having plugged that rat hole, then I would be one of the strongest advocates of pay as you go insofar as it is conceivably possible. But 85, 90, 95, or so billion dollars is far beyond the possibility of the pay-as-you-go plan, even on the basis of confiscation.

Senator MILLIKIN. We have been trying for weeks here to get someone to suggest just how we could cover a 20 or 30 billion dollar deficit——

Mr. ALVORD. It cannot be done, Senator.

Senator MILLIKIN. What you say is in harmony with all the testimony we have had on the subject.

Mr. ALVORD. It cannot be done, and consequently, I think it would be very well for this committee to study the present methods of financing deficits, and see if you cannot come up with better ones. You are going to have to finance a deficit in 1953, and I would strongly urge that this committee come up with policies of deficit financing which are noninflationary, and I think it can be done.

But so long as we continue to borrow from the commercial banks, we are just pouring more water into the stream than the stream can possibly carry off.

Senator MILLIKIN. Off the record.

(Discussion was continued off the record.)

Mr. ALVORD. Now, let me show you the consequences of the House bill for just a minute. Let me assume a man with an income of say, $80,000, and fortunately in America it is still possible for a substantial number of men to make $80,000, but just so that I am not accused of representing only the "filthy rich," let me talk about myself.

Do you know how much it costs me to buy a Ford automobile under the House bill? $35,000.

Do you know how much it costs me to buy a $25,000 house? $400,000.

Do you know how much it costs me to buy a suit of clothes? $2,275.

Do you know how much it costs me to buy a pair of shoes? $455.

A doctor's bill of $100 will cost me $2,000 a hospital bill of $500 will cost me $9,090.

And if you want to go down to a very practical question, to send my boy to college, and he goes this year—will cost me $58,000.

Now, let us get down to something even more practical. I will have to make $20 to buy a pound of coffee; and I will have to make $2 to buy a 10-cent-glass of beer.

Senator TAFT. I do not quite admit those figures. I know the theory of them.

Mr. ALVORD. It is perfectly simple; I will guarantee the figures.

Senator TAFT. No; you cannot prove it.

Mr. ALVORD. It is perfectly simple.

The answer is I will not buy the Ford or the house. These figures are all based on the additional income which I must make if I am going to live within my income——

Senator TAFT. To which some appropriation must be made for you.

Mr. ALVORD. No; which I must make individually.

Senator TAFT. You must be a very rich man.

Mr. ALVORD. I cannot do it. The answer is I cannot do it. It is utterly impossible and foolish. On top of that you also state to the man who makes in excess of $80,000, "Until you make $433,000, we are going to tax you for more than 100 percent of your increased income."

Now that, I would suggest, is probably the direct consequence of legislating by caucus, as they did in the Committee on Ways and Means.

Senator TAFT. I suggest, however, that a lot of this is passed on to other people in order that you may have that money. You double your legal fees, and people's salaries have been increased because they have to pay large taxes.

In other words, these taxes, as they stay they get passed on in the economy to other people and they are spread out over the great bulk of consumers, so that I think what you say, while it makes the point, is not true; it just is not true.

Mr. ALVORD. The gross is not true. How you make that money is the point that I raised. I wish I could double the legal fees.

Senator TAFT. You have over the last 10 years if you are like any other lawyer.

Mr. ALVORD. I doubt very much if my gross has increased very much during the last 10 years. I am getting a little bit older, Senator, than I was. But in any event, I can assure you that that opportunity which we used to hold out to individuals is completely abolished. We used to tell the individual, "Now, listen, just work a little bit harder, get a little more efficient, make more money and you can pay the tax increases."

That is utterly impossible under the tax bill, and equally impossible under the Corporation tax bill. If I were planning a tax program for 1953, I will be more specific now, I would base 60 percent of the necessary increases—gentlemen, using a term that is political anathema—on either a manufacturer's general sales tax or a retailer's general sales tax or a combination of both. Sixty percent of the revenue I would get from that source.

Now, I quite well realize that it is said that you cannot do that this year, but you must lay the tax foundation for 1953 this year if you are going to do anything this year.

Senator MILLIKIN. How much money would you raise by those taxes that you referred to?

Mr. ALVORD. Senator, it depends, of course, on exemptions, and I realize that any bill that goes through the Congress will have exemptions to it.

Roughly speaking, for every 1 percent of a manufacturer's tax you will get $800,000,000 and for a one-point retail sales tax you will get a billion.

Senator MILLIKIN. As a practical matter, would you anticipate, considering the exemptions which you wisely foresee as being inevitable, that you could possibly raise more than $5 billion that way?

Mr. ALVORD. I would not raise more than $5 billion in 1953 that way, but I would get the tax on the books, Senator, so that we stand some chance of getting more revenue if we want it.

Senator MILLIKIN. If you want to get it on the books, you would get it on this year, you said you do not need it this year.

Mr. ALVORD. January 1, 1952, is the date that I would hope to make this sort of a tax effective.

The 30 percent I would get from individuals, not through the confiscatory, purely arbitrary, unsound and unrealistic proposals of the House bill, but through a one-, two-, or three-point increase in existing rates.

After all, that is the way the reductions came down; that is the way they should come down. I do not think I would decrease credits because the $600 credit is not worth much more than $300 today.

Senator MILLIKIN. The reductions did not come down flat. They came down in reverse progression.

Mr. ALVORD. They came down in inverse——

Senator MILLIKIN. Reverse.

Mr. ALVORD. Reverse.

Now, we are putting them in inverse reverse.

Senator MILLIKIN. We gave the highest reductions to the lowest income brackets.

Mr. ALVORD. That is right, Senator. Then I would collect not more than 10 percent of the increase from corporations subject to an overriding principle that under no circumstances would I impose a tax, whether we called it a normal tax or an excess profits tax, on corporate incomes, normal corporate incomes, in excess of 50 percent. I do not believe that a rate in excess of 50 percent can be tolerated even temporarily, and every one agrees we cannot stand it more than temporarily.

Now, I do not know how long this cold war is going to last, no one does, but the best picture we can get of it is that it probably will last during my lifetime, and perhaps through the lifetime of each of you gentlemen on the committee. Certainly it will last during our period of, call it reasonable earning power. Maybe we can maintain present incomes for another 5 to 10 years, and then we will begin to slip. It is just normal. That is what age does to us.

So that represents the basic principle upon which I would approach 1953. If I wanted to collect taxes from a capital gains tax, I mean net revenues—we do not get much revenue these days from the capital gains tax—I would reduce the rates and certainly never increase them. A lower capital gains tax will produce more revenues for you than either the existing law or the proposed 12½ percent increase in the House bill.

Senator MILLIKIN. How about shortening the period?

Mr. ALVORD. Shortening the period will give more revenues.

The period on the holding of capital gains represents a matter of judgment. What we are trying to do is to draw the line between honest investments and those who make a business of speculation.

Three months, I think, does it. Six months, I am sure will do it. The opinion of others more familiar with the speculators, for example, say that 3 months is adequate. It will certainly produce more revenues.

Senator TAFT. It seems to me the case for a short period to produce more revenues is clear. I am not so perfectly sure about a case for producing more revenues by reducing the rate. That certainly is not true. I mean if you reduce it to nothing then you get no revenues at all.

Mr. ALVORD. I am not so sure that would not produce money, Senator.

Senator TAFT. So it does not go on indefinitely.

Mr. ALVORD. I am not sure it would not produce money. Most of the countries in the world have a zero rate on capital gains.

It cuts all possible losses out; I do not think we would lose money on the zero rate, but we are not prepared to do it.

Senator TAFT. I would like to see that case presented. People keep saying that we get more money from a lower rate. It is easy to prove that the period thing produces more money.

Senator MILLIKIN. Is not your point that if you do away with capital gains taxation entirely, at least, so far as the upper income bracket people affected by it are concerned, their capital becomes income earning, and thus it carries higher rates of income taxes?

Mr. ALVORD. No.

Senator MILLIKIN. No?

Mr. ALVORD. No, because their capital transactions would be exempt from tax.

Senator MILLIKIN. When they realize the money, they make an investment which is income-producing, and the income from it——

Mr. ALVORD. Oh, yes.

Senator MILLIKIN. At least to the middle and upper income people carries the higher rates of tax.

Mr. ALVORD. That is true, Senator. I did not get the question.

Now, let me follow your idea for just a moment. Most capital gains today are the result of inflation. Consequently, if this inflation continues, as Senator Millikin and I think it probably will if present policies are continued, you are taxing capital and it will not be long before you will hear almost everyone before you advocate no tax at all on capital grains. I am not advocating that today, but I would advocate a reduced rate.

Capital gains, Senator Taft, as you well know, are the results of almost entirely an intentional sale of property. You must have a buyer and you must have a seller.

Now, today every time I consider—just let me give my own views so I do not express the views of others—a sale of property on which I have a gain, I say, can I afford to pay 25 percent of that gain to the Government? Is it not smarter for me to hold it? I am still getting a yield on my original cost. Is it not smarter for me to hold the property? A 25 percent rate, I am sure, influences me a great deal to continue to hold. A lower rate would wipe out that influence to a very large extent, and you would have many more sales.

While we are on capital gains, Senator——

Senator TAFT. I do not think, though, if you reduced your capital gains from 25 to 12½ you would get twice as many sales.

Mr. ALVORD. Many more.

Senator TAFT. Many more? I do not think twice as many. I do not see any evidence of it or any proof of it in what has happened, and I personally would be inclined to abolish the capital gains tax myself, that is my inclination; but I am only saying that people who contend that have not furnished any conclusive proof of the fact, and I do not think that to reduce the tax from 25 to 12½ is going to produce as much revenue—twice as much revenue.

Mr. ALVORD. There are no statistics, Senator. If you take history——

Senator TAFT. If you double the 25 to 50 percent, I think, perhaps, that would defer all sales and you would get less money; that is a possibility.

Mr. ALVORD. If you take history, you will see receipts from capital gains increased from 1921 straight through to 1930, with a declining rate all the way and you got more net revenues.

Senator TAFT. But you also had a steady increase in transactions and in sales and in stocks and we had a stock inflation and all that, so that it is a little hard to say that that proves the point.

Mr. ALVORD. It is hard to say. It is a matter of opinion. Now, whether we would get twice as many transactions with a 12½ percent rate, my guess is we would. I know of transactions being held up.

Senator MILLIKIN. The more rapid turn-over produces more money at a lesser rate.

Mr. ALVORD. That is right, sir.

Senator TAFT. If you go down to zero, there is some point at which you get your maximum revenue. That is a guess.

Mr. ALVORD. I am not sure as to your guess of a zero rate producing a loss.

Senator TAFT. Well, it obviously produces no revenue from capital gains.

Mr. ALVORD. That is right, but you pick up on other revenues a great deal, just as Senator Millikin pointed out.

Senator MILLIKIN. These contentions go on and on and on, and you cannot reach a solution until you try it. What would you think of an experimental try?

Mr. ALVORD. I would like to see it.

Senator MILLIKIN. What would you think of an experimental try, reducing the period and reducing the rate and see what happens?

Mr. ALVORD. I would like to try a 15-percent rate for a 3 months' period, and see what happens. That is what I would like to see you do.

Senator TAFT. I think a 50-percent rate would choke everything. It would choke everything. Of course, this rate in the House bill is increased from 25 to 28 or something——

Mr. ALVORD. Twenty-eight and one-twelfth, I think.

Senator TAFT. Twenty-eight and one-third.

Mr. ALVORD. Now, you see you are dealing with the psychology of investors. For many years it has been the position of the Congress not to increase the rate on capital gains.

You raise the capital gains tax three points, and what is the investor going to think? It looks like they are going to push this rate beyond all possibility, and what you do is remove all hope, and the only hope there is now in any equity financing is a hope for capital gains. The income from it is not worth anything. You have completely dried up the sources of equity financing.

Senator MILLIKIN. You are also dealing with the psychology of the voters.

Mr. ALVORD. That is true. That I appreciate, Senator, and it has always been my position to state what I think is sound policy, and you who have to get votes have to take those policies and discard them or revamp them, depending on the voter. Fortunately I am not a politician.

Senator MILLIKIN. It would not be a bad idea for all who are interested in taxes to give some attention to what can be done and what cannot be done, considering that Congress is and should be a political institution.

Mr. ALVORD. Well, Senator, for 30 years at least I have always considered that my position was worth more to you people if it was not salted with political flavoring. I can tell you what I think sound policy is under given circumstances, and it is up to you in politics to decide what is politically possible and what is not. I do not know. I have never had a vote in my life for anything.

Senator WILLIAMS. If you reduce the holding period to 3 months, as you point out, unquestionably the revenue would increase in that bracket, I mean from a capital gains levy but is it not also true that we would have to face the fact that the normal income tax revenue would decrease some to offset that because those transactions that were now in between the 3 and 6 months' period were sold and converted over into capital gains, and increasing that they would likewise decrease the amount that a man would be paying in his normal income. There is an offset to your gains.

Mr. ALVORD. I would discount that offset very considerably because today this is the present practice. A person, if he holds a security say, for more than 3 months, sells, if he has a loss, in order to realize a short-term loss. He holds it if he has a gain, so that your short-term loss between that 3 months and 6 months would probably represent a very substantial portion of the sales.

Senator WILLIAMS. But that same proportion of the sales—and that same thing could be true with the 3-month period left as it would be?

Mr. ALVORD. Yes, but short-term losses in 3 months, I assume, would be considerably less than in 6 months.

Senator WILLIAMS. I have seen them——

Mr. ALVORD. So have I, but I am talking about general principles now.

Senator WILLIAMS. But there is an offsetting provision to this gain.

Mr. ALVORD. We do not expect to get a loss in 3 months buying.

Senator WILLIAMS. You do not really expect to get it in 6 months.

Mr. ALVORD. That is true, but the likelihood of a loss in 3 months is less than in 6 months, and we would only have 3 months in which to convert our loss into a short-term loss, and a 15-percent rate would, I am quite confident, greatly reduce the incentives to hold, or the incentives to buy, or the incentives to sell based on tax consequences, and it would get you into a market based more on values.

Senator MILLIKIN. There are inflationary angles considered, but for goodness sake, do not let us go into that.

Mr. ALVORD. Let us not go into those.

I would like to suggest—the committee has no policy—while we are talking capital gains, I would like to suggest this rather simple policy that any person who sells, in order to convert into a different investment, could well do so tax-free. That would follow along Senator Taft's concept of no tax on capital gains if we convert. It is the same principle you have here on private homes.

I would like to see the experiment with that idea. Certainly it is true in the case of trusts and estates. They should be able to convert their investments with no gain, and I think that the individual should, too. It is worth considering. I am just reminded that that seems to be the policy that Senator Ball just advocated to the committee, for ships. I did not hear the testimony, so I do not know.

Now, those give you my basic policies for 1953. I think I do not have to state my objections to the House bill any more completely than I have.

I would scrap the House bill completely and I would build a tax bill more in accordance with sound tax policies and for the purpose of 1953 and thereafter.

Now, how long our demand for exceedingly high revenues is to continue I do not know. If it continues long enough, Senator, you are going to have everybody in this country, which means the private citizen who runs his own business, coming to the Congress for retirement pay. While I am on the subject, I certainly think that the retirement-plan provisions should be made applicable to unincorporated organizations.

Also, while I am on the subject, I think this country could well, at the present time, adopt a very general policy with respect to foreign investments, and it might save you a great deal in your foreign aid.

I think it would be eminently sound to exempt from tax all investment income earned abroad, dividends and interest, basically.

Now, we are, just as much as you are, sincerely hopeful that this inflationary trend can be stopped. There is a great deal of misunderstanding about inflation, and the word is used very, very generally. The basic cause of inflation that I am concerned with is what we call monetary inflation. There will be increased prices, certainly, as you take the supply away for military use. Prices would normally increase just by reason of a lesser supply with the same or greater demand. There will be price increases as costs increase.

From the point of view of taxes, I would certainly remodel the excess-profits tax so that we can continue to progress and expand and get new products and new markets, so that we can continue to explore, discover, and exploit natural resources, so that we continue research and bring out such things as aureomycin, streptomycin, and so forth.

The excess-profits tax says: "Thou shall not do those things."

I still think there is a chance to resusciate depressed industries, and I think there is a chance to revive businesses that are almost lost, but it cannot be done under your present tax system.

I think that presents about all the views I have, Mr. Chairman, and gentlemen. I could talk on this subject for hours, as you know, but I think that I have covered everything that—I am reminded of something.

Senator TAFT. Mr. Alvord——

Mr. ALVORD. Yes, Senator.

Senator TAFT. To the matter we are talking about, the budget estimate for MDAP, that is Military Defense——

Mr. ALVORD. That is right.

Senator TAFT. And other foreign aid in January was $7.1 billion of expenditures.

Mr. ALVORD. Expenditures, yes, sir.

Senator TAFT. The revised estimate is only $2 billion. They have cut the whole saving in the cut that they have estimated—it comes in the $5 billion for foreign aid and, consequently, I do not think when you are talking about expenditures in this fiscal year, you are going to be able to save any more on foreign aid.

Mr. ALVORD. I have analyzed that, Senator, and I think you will find that that purported cut—which I do not think is $5 billion—represents a transfer of that foreign aid over to the military.

Senator TAFT. Well, that may be but it is transferred over to the Defense Department which has increased from $40 to $42 billion, and the MDAP, and other foreign aids, ECA is cut from $7.2 billion——

Mr. ALVORD. I do not think that you will find ECA in there. You will not find ECA in there at all. I am quite sure you will not.

Senator TAFT. Oh, yes; it is in there.

Mr. ALVORD. I doubt it.

Senator TAFT. Oh, yes. There is the official——

Mr. ALVORD. Yes; I know.

Senator TAFT. So that I am only saying that you are not going to cut this $68 billion of expenditures any further by reductions in foreign aid, so far as this fiscal year is concerned. As to the next fiscal year, that is a tremendous difference.

Mr. ALVORD. I will try to tell you what they did in the estimate that you have got there. They did some juggling between MDAP and other foreign aid, and the military functions of the Defense Department. In your 1951 estimate they total $47.1 billion. In the July 1951 revised estimate they total $44 billion, and I think that is the figure you have there, showing a cut of $3.1 billion. If we could analyze it I think you would find it is all in the military and not in the foreign aid.

Senator TAFT. It is not what they tell us then.

Mr. ALVORD. It is not explained, and we think it is in the military.

Senator TAFT. That is another thing. That is what—that is not what they say.

Mr. ALVORD. I do not have the benefit of what the administration says, but ECA—on the last figures I have, contemplated for this fiscal year——

Senator TAFT. The only note here is that the revisions are based on detailed military budget. They say "rate of deliveries of military equipment lower than anticipated in January."

Mr. ALVORD. That is right. I think the entire cut is in the military and represents a slow-up. It is not a cut in final expenditures, but it is a slow-up.

Senator TAFT. That is right.

Mr. ALVORD. I do not think foreign aid is going to slow up quite that much. At least ECA apparently is not.

Senator TAFT. But you start with a figure of $68 billion in estimating your deficit.

Mr. ALVORD. That is a current estimate.

Senator TAFT. Which already has eliminated $3 billion in foreign aid. That is the point I am going to make, and they are going to estimate another $3 billion cut in foreign aid.

Mr. ALVORD. Let me try to make this clear, the January budget came up with a figure of $41 billion for the military. It was stated in the January budget that that was only an estimate then because they had not prepared the budget.

Now the $38 billion is merely a substitute for the $41 billion because they discovered as they began to make their actual budget estimates of expenditures, that they could not spend the $41 billion, and cut it down to $38 billion. There is no saving at all. It is just a $38 billion figure estimated for $41 billion, so there is no saving in it.

Senator TAFT. I agree with that. I am only saying that the $68 billion in which you start, in the absence of a deficit, you cannot deduct for savings in foreign aid, which have already been counted in those figures.

Mr. ALVORD. I think $3 billion does not include foreign aid. It is almost entirely due to a delay in the military period. I do not have the information that you have, but I would suggest, if I am wrong, that you get them accurately corrected.

Senator HOEY. Thank you very much, Mr. Alvord.

Mr. ALVORD. I call especial attention to that part of my statement with respect to withholding of the 20 percent on dividends, interest and royalties. We oppose it very violently.

We tell you it will cost a great deal of money and will produce a great deal of hardship.

The point there that I might suggest you consider: If you start with withholding, the poor recipients never catch up. What you do is to take 20 percent of his income the first year, and he never catches up. Now, that applies to your individuals, you nontaxable individuals; it applies to your charities, your charitable organizations and everything else. This committee killed it last year, and I trust you will kill it again.

Senator HOEY. Thank you very much.

Mr. ALVORD. Thank you, sir.

(The prepared statement and technical and administrative amendments referred to follow:)

STATEMENT OF ELLSWORTH C. ALVORD, CHAIRMAN, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES

INTRODUCTION

My name is Ellsworth C. Alvord. As chairman of the committee on Federal finance, Chamber of Commerce of the United States, I am submitting for your consideration the views of the chamber, based upon the recommendations of its committee, concerning new and additional taxes.

STOP-LOOK

Almost exactly 1 year ago, the Secretary of the Treasury urged you to enact the tax reduction bill of 1950—which had been passed by the House of Representatives 4 days after Korea. Almost simultaneously, we urged that the proposed tax reductions be postponed. In our opinion, Korea had made the proposed reductions inadvisable and we were quite certain that tax increases would prove necessary. Within a few days the administration joined us. The Revenue Act of 1950 and the Excess Profits Tax Act of 1950 were adopted by the Congress by the end of the year.

We again urge a policy of "Stop and look."

THE 1952 BUDGET

The Secretary of the Treasury, in January of this year, told the Congress that $16.5 billion additional revenues were needed to balance the 1952 budget. He urged a "quickie" bill of $10 billion—that is, one dictated by the Treasury for adoption without adequate consideration.

Consistent with its earlier position, the Treasury is precipitate again. The 1952 budget can be balanced without additional revenues.

A cash deficit is not forecasted.

Estimates (in round figures) for fiscal 1952 before your committee are:	*Billions*
Expenditures	$68
Receipts	61
Possible budget deficit	7

The actual expenditures, however, should be several billion less (without considering the "cuts" we are urging), and revenues at least $2 billion higher. But even on the basis of the figures as shown, the simple safe and sensible way to balance the 1952 budget is to cut $7 billion from the proposed expenditures.

Additional revenues should not be necessary to balance the 1952 budget and should be neither advocated nor imposed for that purpose.

We make this statement even though we observed 3½ months ago, in our presentation to the Committee on Ways and Means, that application of pay-as-we-go might require additional revenues.

Developments since then, including changes in official estimates of revenues and expenditures, support the position we took that, with feasible reductions in less essential expenditures, no such amount of additional revenues as proposed by the Treasury was needed.

We advocated specific cuts in expenditures totaling $7 billion. These included no reduction in the total of military expenditures proposed—without specification—in the budget message. We stated, however, that the feasibility of reducing this total should be examined carefully.

We observed that from the facts then available, it might be necessary to raise a few billion dollars more of revenues to assure pay-as-we-go, but that less than $5 billion should be ample, reserving a specific total until the military budget and new estimates of other expenditures and of revenues became available.

We suggested that if it is clearly demonstrated that new revenues for fiscal 1952 should be sought, a general sales tax, either at the manufacturer's level or at the retail level, should be the main dependence. We recommended that if increase in the income taxes could not be avoided, the new revenues should be sought approximately 60 percent from excises (including the general sales tax), 30 percent from the individual income tax (through addition of percentage points to present brackets), and 10 percent from corporate income tax (through moderate increase of the normal rate).

That is still our position. We believe, however, that the prospect of a budget deficit (not to say a cash deficit) for fiscal 1952 is not now such as to warrant assumption of the risks involved in imposing crushing taxes to raise even a few billion dollars of additional revenues, with the danger of upsetting the whole economy.

If it is established some months from now that larger receipts should be sought for fiscal 1952, we believe that new or additional taxes should not be retroactive; that they should not become effective before January 1 next, or possibly later.

We wish to make it clear, in urging such an approach, that we are not unwilling to support a program of additional taxes should the need for them be established and the burden spread widely and equitably.

THE 1953 BUDGET

Attention has been concentrated upon the possibilities in 1953. But there are no reliable estimates whatsoever available for 1953. We hear that expenditures may exceed $80, $85, $90, or $95 billion. Several weeks ago I heard $125 billion mentioned as a possibility. Expenditures on any such level cannot be financed by taxes—even "temporary" taxes.

TIME TO LOOK

Now is the time for the administration and the committees of Congress to study and evolve sound fiscal policies for the future. There may still be time.

The program should include, but need not be limited to, the following:

(1) Cutting down expenditures—and the military should not be spared.
(2) Monetary and credit policies.
(3) Debt management.
(4) Taxes.

THE PROBABLE PICTURE

If the next 5 months are devoted to the suggested studies, we confidently predict the following conclusions:

(1) Our fiscal policies, especially the Government's spending and lending policies, have been the blood stream upon which inflation has fed and fattened.

(2) A continuation of present fiscal policies will lead to further and possibly uncontrollable inflation.

(3) There are fiscal policies which will help immediately in our fight to prevent further inflation.

(4) There are no effective "brakes" for inflation so long as we keep our foot on the accelerator.

(5) Unless sound fiscal policies are adopted, we will continue to confiscate the savings and earnings of our people and to aid the enemies of our freedoms and opportunities. Whether the result is socialism or communism, or some other form of dictatorship and tyranny, is inconsequential.

(6) If sound fiscal policies are adopted, our national defense program should prevent war and we shall have a real chance through leadership and a restoration of confidence in us and our objectives to promote and maintain peace and to succeed in our fight for religious, civil, economic, and political freedoms.

A LOOK AT THE PRESENT

An expert photographer need not be employed to give us a picture of the present.

Internationally

(1) Our potential military power is feared—free nations know that development of military strength can lead to war.

(2) Our economic strength is questioned—our friends abroad fear that if we slip, we shall pull them with us.

(3) Our policies of aid and assistance are misunderstood—it is feared that political domination must be the undisclosed motive.

(4) American inflation has occasioned more economic damage and tension abroad than the Marshall plan has or could overcome.

Nationally

(1) It is generally assumed that the present international emergency is of indefinite duration—and may continue for a decade or more.

(2) Existing tax rates cannot be borne for any such period—the damage will be much more costly than the revenues produced, and much more costly than the failure to raise huge additional revenues.

(3) The Revenue Act of 1950 and the Excess Profits Tax Act of 1950—designed to increase revenues by an aggregate of about $10 billion—were both intended to be "temporary and emergency" measures.

(4) Our greatest military potential is our productive capacity and ability.

(5) Our system of free, private, competitive enterprise, upon which we rely for the production of the goods and services required for military and civilian use, is being stifled—it can be destroyed.

(6) The Excess Profits Tax Act of 1950 must be completely revamped—if we approve and desire progress, growth, expansion; research, exploration, development; new products, new methods, discoveries; the survival of small business.

PAY-AS-WE-GO

The National Chamber urges that the Congress try realistically to apply the principle of pay-as-we-go through the reduction of less essential expenditures. Only then should new or increased taxes be sought.

A balanced budget must be the objective over a period of years, when defense expenditures rise and inflation may menace. But that objective should be attained mainly through the elimination, reduction, and postponement of nonessential spending, and through the elimination of waste. With expenditures and spending policies under control, revenue requirements can be faced with hope and perhaps confidence.

The application of the principle of pay-as-we-go, solely by increasing taxes, is not the answer. It must be realized that other policies and actions have a direct influence upon control of inflation. Spending policies, monetary policies, debt management, borrowing and lending activities, controls, and related questions have a dominant role. Individual and business savings are highly important in combating inflation. Taxes frequently contribute to inflation.

The chamber has urged, in this period of defense emergency, domestic economic policies which will most effectively gain our ends by building and preserving our economic strength.

It has stated that the objectives of these policies should be:

> To achieve maximum use of the productive potential of private industry.
>
> To promote the most effective balance of economic output as between military and civilian needs, and within these two categories: (*a*) To restrain inflation, (*b*) to distribute the burdens of mobilization equitably and efficiently, and (*c*) to maintain the vitality of an economy with free competitive markets.

To meet these objectives it has urged a number of economic policies. With regard to inflation, it has stated that there should be main reliance on indirect controls which strike at the sources of inflation. It recognizes that new and additional taxes may become necessary to assure pay-as-we-go, consistent with necessary expenditures, and consistent also with maintaining incentives to work and produce.

The chamber believes, however, there should be firm adherence to the policy that Federal taxes should be levied for the purpose of obtaining essential Government revenues, with careful weighing of collateral effects, and not for social reforms.

A LOOK AT THE HOUSE BILL

One look at the House bill is both shocking and conviciing.

(1) It embraces no basic revenue-producing policy which should be adopted; and

(2) It violates the policies which should underlie a sound fiscal system.

We deal now with the more important specific provisions of the bill.

THE PROPOSED INDIVIDUAL INCOME TAX INCREASES

The Revenue Act of 1950 increased the burden of the tax on individual income. It is now proposed to increase the burden again, this time by one-eighth of the total tax as determined by present rates. The superficiality of this approach has been amply demonstrated by the initial action of the Ways and Means Committee which found this method, without the subsequent change, placed a tax of more than 100 percent upon individuals in brackets of over $100,000 of taxable income.

Raising the individual income tax as the House proposes increases disproportionately the already highly progressive rates. Comparison of the effect of the proposed 12½-percent increase in tax liability on the "take home" pay of individuals in the various tax brackets shows this clearly. In the case of an income below $5,000 the increase, depending upon marital status, will take from about one-half of 1 percent to 3 percent of the income retained after taxes, but in the case of an income of $100,000 from 13 percent to 24 percent.

At a time when rapid productive expansion is imperative there is grave danger that excessive tax burdens placed upon individuals will impair both their incentive to produce and their ability to invest for production.

In any endeavor to increase Federal revenues from the individual income tax, it should be recognized that serious risks are involved, requiring the exercise of great caution.

It has been demonstrated repeatedly that confiscatory rates placed upon the income of individuals which lies in tax brackets over $10,000 would produce less than $3.5 billion and not only would preclude industrial financing by individuals but would destroy our American system.

The bill increases most harshly the tax upon individuals already hit the hardest and, with other levies upon them, could destroy revenue potentialities of middle-sized or higher incomes.

At least 10 of the 31 States which levy personal income taxes do not permit the deduction of Federal income taxes. This is true also of the District of Columbia. In six States the combination of income taxes would produce a rate higher than 100 percent, where the proposed Federal rate of 94.5 percent would apply, namely, on taxable incomes of $80,000 (single returns) or $160,000 (joint returns).

Any raise in the individual income tax should be applied by adding points to the basic rate, the method advocated by the Secretary of the Treasury.

PROPOSED CORPORATE INCOME TAX INCREASES

The proposed 5 percentage point increase in the corporate income tax is clearly excessive. Within the past year corporations have suffered the largest tax boost of all taxable categories. The Revenue Act of 1950 raised corporate normal and surtax rates from 38 to 47 percent and a 30 percent excess profits tax was added early in 1951. These two acts will double the tax revenues from corporations.

Corporations fully expect to bear their just share of the tax burden. Discriminatory increases, even in time of emergency, may defeat the primary objective of maximum production.

Corporate financing today comes largely from retained earnings and borrowings. Individuals are no longer able to supply equity capital sufficient to meet corporate needs for replacement of equipment and industrial expansion. Should too great a portion of corporate earnings be drawn off in taxes, industrial financing requirements would lead to greatly increased borrowing from banks or Government sources. Over reliance on either method would mean unsound corporate financing.

Much has been said about the magnitude of corporate profit, with little recognition that these profits today are highly overstated. Established depreciation allowances have failed by many billions of dollars to meet cost of replacements. Inventory profits, too, are illusory. And certainly the more than $100 billion investment since World War II in new plant and facilities is entitled to a reasonable return.

As a percentage of gross national product or income the total of corporate profits is smaller today than in many past years.

Increase of corporate taxes should be avoided in the public interest if at all possible. Tax-exempt competitors of corporations should be required to pay equivalent taxes.

If it should become unavoidable to increase the tax on corporations we urge that the combined normal and surtax be kept below 50 percent. Even the present rate much exceeds that of the World War II period.

No change in the corporate rates should be made retroactive as proposed in the House bill. The increases imposed on corporations by the Revenue Act of 1950 did not become fully effective until July 1, 1951. Overlapping tax increases are not justifiable.

Corporate earnings are taxed first in the hands of coporations and, when distributed as dividends, are subject to the individual income tax. The chamber has steadily maintained that the impact of the high income taxes has demonstrated the unfairness and unsoundness of the double taxation. Further increases in the corporate or individual income tax rates intensify the gravity of the situation, which already requires alleviation.

Ideally, the tax rate on corporate incomes should be the same as the basic rate on the income of individuals, with dividends received by individuals exempted from this basic rate and made subject only to the individual surtax. While this presently is not practicable, it does seem advisable to provide for the exemption of dividends received by individuals from a portion if not all the basic rate on individual incomes. Without resort to an undistributed profits tax there should be early diminution, and eventual elimination, of the harmful double taxation.

PROPOSED EXCESS PROFITS TAX INCREASES

Under any circumstance, the so-called excess profits tax is fundamentally a bad tax. It is impossible to frame legislation accurately defining either normal or excess profits of all corporations.

To impose an excess profits levy on ordinary income, as the 85 percent base period credit in the present law now does, is, beyond question, unfair. To increase this inequity, as the House bill proposes, compounds the nature of the injury.

A relistic base-period credit would be at least 100 percent, and possibly higher to compensate for the lowered purchasing power of the dollar. Other important changes should be made, as suggested later in this presentation, if the tax cannot be repealed. Certainly, the position of the Secretary of the Treasury that the tax should not be increased until there is opportunity to observe its operation should be endorsed.

LIMITATION ON SURTAX EXEMPTION AND EXCESS PROFITS CREDIT

The proposal to limit an affiliated or related group of corporations to a single surtax exemption and one minimum excess profits credit would seriously injure many businesses which, for sound operational reasons, and in some situations unavoidably, have organized separately.

CAPITAL GAINS RATES

The proposal to increase the alternative capital gains rates, for both individuals and corporations, by 12½ percent is explained as being necessary because of the increase in the individual income tax. This is a nonsequitur, failing to recognize the essential difference between capital gains and ordinary income.

The bill also would change the method of applying capital losses against capital gains.

Both these proposals should be rejected. If additional revenues are sought, the rate should be reduced. If fairness is a consideration, the rate should be lowered and excess losses should be deductible. If a capital levy is to be avoided (recent appreciation in the value of capital assets being a consequence of inflation), then there should be no tax upon capital gains, which is the established policy in many other countries.

EXCISES

If additional revenues prove necessary, Congress may increase some of the existing excises, reduce some of the highest ones, and add new ones. Even so, a general sales tax would be advisable.

There is undue reliance upon the income taxes as sources of revenue. They tend now to pass the point of diminishing returns. Higher rates will further aggravate the situation. A general sales tax will operate not only to decrease dependence upon the income taxes but also to restrain spending. It can be established upon a practical basis, with minimization of pyramiding. It should be looked upon as a necessary supplement to the income tax.

We append a summary of the relative advantages of applying a general sales tax at the retail level and at the manufacturing level.

WITHHOLDING TAX ON DIVIDENDS, INTEREST, AND ROYALTIES

The House bill proposes a withholding tax of 20 percent on dividends and on interest paid on corporate obligations, deposits with stockbrokers, insurance proceeds, certain tax overpayments and royalties. The plan contemplates a gross withholding without any exemptions and without any report to the Treasury Department of the persons from whom the tax is withheld.

There would be no requirement that the corporation advise either the stockholder or the Government of the amount of tax withheld from each individual stockholder. Claims for refund on the part of persons or organizations not subject to the full amount of the tax would be approved by the Government.

If this proposal becomes law, there would be substantial over withholding for persons in the low-income brackets not ordinarily subject to tax, for certain tax-exempt organizations where no tax at all is due, and for holding companies whose assets consist primarily of corporate stock.

It would prove a tremendous hardship on all individuals who expect to receive less than $600 total income from all sources for the year. These persons, who may be widows and orphans, would be required to file claims for refund for the nominal amounts withheld. In many cases, they might fail to receive the refund because they might not be aware of the proper method of obtaining a refund payment.

Certain tax-exempt organizations would be deprived of a percentage of their income until refund claims are filed and acted upon. While the bill proposes some relief to tax-exempt organizations with employees subject to wage withholding, it must be borne in mind that there are many tax-exempt organizations without paid employees. These organizations are generally more in need of financial assistance than those with paid employees and the bill provides them with no relief from overwithholding.

It is estimated that at least half a million individuals would be eligible for refunds under this plan and all of them would lose part of their income until refunds had been made.

Consider, for example, the married couple over 65 who are entitled to exemptions totaling $2,400 per year and assume their sole source of income is dividends on stock. Although Congress does not believe they should be subjected to tax, 20 percent, or $480, of their income would be taken from them and withheld until they could prepare claims for refund and the refund made by the Government. Or take the case of a taxpayer who is blind and over 65. A sizable portion of his income may be taken from him. It will be little comfort to him to be told that he can file a claim for refund at a subsequent time.

Trustees of nearly every small trust would be required to perform much extra work under the withholding plan. Dividends and interest would have to be apportioned between the beneficiaries and the trust. Claims would have to be filed for refund of the trustee's share of the income tax in every small trust. In addition each beneficiary would also have to file a separate claim for his pro rata share of the tax withheld. These are just a few examples of the effect of such a withholding plan. Such examples would be multiplied many times over.

Any holding company whose principal assets are corporate stocks would be in a difficult position. Only 15 percent of the dividends received are subject to corporate tax, yet 20 percent of the total dividends would be withheld. This is an effective withholding tax of 133 percent.

A number of corporations pay dividends in property rather than in cash. The bill provides for an exemption from withholding of dividends paid in the stock or rights to acquire stock of the distributing corporation. No provision is made for exemption from withholding in the case of dividends paid in other types of property. The payment of such dividends would encounter insurmountable difficulties under the proposed withholding. It would be necessary for the paying corporation to collect the withholding tax from the recipient of the dividend even though the recipient might not be subject to income taxes at all.

Another minor problem would result in constant taxpayer irritation. This problem has to do with such a simple matter as fractional cents. For example, a corporation declares a dividend of 62 cents per share on 1,000,000 outstanding shares. This is a total dividend of $620,000. Under the proposal, the company (or its dividend-paying agent) would remit 20 percent, or $124,000, to the Government. How much shall the company (or its paying agent) pay to the holder of seven shares of stock? If $3.48, the stockholder is overpaid and if $3.47, the stockholder is underpaid. It is no answer to say that fractions less than one-half cent will be dropped and those over one-half cent will be increased to a full cent for there will always be either money left over or a shortage and the corporation (or its paying agent) can never balance its accounts. Of course, the amount will usually be small but how can the overage be disposed of and how can the shortage be made up? Multiply this by thousands of times and the taxpayer irritation can destroy confidence in the whole withholding system. The bill attempts to meet this problem but it seems hardly adequate to provide merely that this can be covered by regulations.

The mechanics of bond interest collections would have to be completely readjusted to the nonpayment at par of interest coupons. Even the simple process of posting books would be affected. One-line entries will become two-line entries, thus increasing the amount of clerical work at a time when manpower demands are at their peak.

Representatives of the life insurance industry have pointed out the difficulties involved in applying the withholding provisions to interest on amounts held by an insurance company under an agreement to pay interest thereon and on the interest paid the life insurance companies on their investments.

I was also explained that interest credited on policy dividends and retained by the life insurance companies becomes an integral part of the accumulated dividend fund subject to the contractual provisions of the policy. This dividend fund may be used in a variety of ways under the terms of the policy contract. It may pay a premium due under the policy; it may shorten the period within which a policy may mature as an endowment; it may extend the term for which insurance coverage is provided after lapse; it may become a part of the policy proceeds at maturity, with all the rights, options, and privileges applicable to policy proceeds.

To require a withholding of any portion of such funds would disrupt the operation of these policy provisions and result in hardship to hundreds of insureds and beneficiaries alike.

It was explained that the bill in effect would require life insurance companies to pay their income tax in advance of the March 15 due date, and also would destroy for them the privilege of paying their tax in quarterly installments following that date. This discrimination arises because such a large amount of the taxable income of a life insurance company would be subject to the 20-percent withholding.

The imposition of the burden of withholding on payors of royalties would substantially increase the burdens of withholding agents. The cost to employers of withholding on wage payments has been substantial. In the case of corporations engaged in the oil business the imposition of a requirement to withhold on payment of royalties would impose an additional regular monthly burden greater than the burden now imposed by reason of payroll withholdings. For example, one oil company has 18,000 employees and withholding tax calculations on approximately 30,000 payments during each month are required. However, with respect to its oil and gas producing activities, there are 80,000 different divisions of interest, each requiring monthly calculations and payments. With respect to delay rentals, more than 40,000 payments are made annually for the account of approximately 125,000 different individuals.

In the case of small corporations and small oil producing companies, partnerships, and individuals who are not large enough to use machine methods economically, such as those used by the larger companies, the cost of withholding on dividends and royalties would be even more disproportionate to the present cost of such companies, partnerships and individuals in withholding on wage payments.

The increase under the bill in the burdens imposed on withholding agents would necessarily result in the use of employees in enforcing the withholding requirements at a time of national emergency and full employment and at a time when such individuals should be employed in activities other than clerical work. Additionally, the Treasury Department would be required to devote an increased amount of manpower to the enforcement of the withholding provisions thereby greatly increasing the already high cost of government.

In addition to the more valuable loss of manpower for the reasons set out in the preceding paragraph, the Government would lose tax revenues by reason of these provisions because withholding provisions would incur additional expenditures which are deductible for tax purposes.

Delay-rental payments with respect to mines and oil and gas leases are included in the definition of the term "royalty" in the bill. As a practical matter, no benefit would accrue to the Government from withholding from delay-rental payments for the reason that it is impossible as a practical matter. This is based on the fact that with respect to ordinary delay rentals the lessee does not know the division of interest in cases where the leases have been executed by more than one person. In one oil company's case, 85 percent of its delay-rental payments are made to more than one individual. In most cases the payments to multiple individuals are made to a depository bank for the account of the individuals and the corporation has no knowledge of the interest which each individual has in the total payment. Therefore, it would be impossible to furnish the Treasury Department with the amount of withholding applicable to each interest owner and each interest owner would, therefore, be unable to furnish proof to the Government from the withholding agent of the amount applicable to the interest which he had received. The same condition exists, to a degree, in the case of payments to owners of an interest in oil-producing properties in those cases where more than one individual is the owner of an interest in the producing property.

A much simpler procedure for insuring the Government that proper taxes are being paid by royalty owners is the system by which information returns are made by the payor showing amounts paid to each individual and the present requirements could be lowered and an amendment to the present law could be made so that all payments of royalties in excess of $100 per year would be reported on an information return. Such information returns, together with the requirements with reference to estimated tax, should be sufficient to furnish the Government with all facts necessary to ascertain the income-tax liability of taxpayers who receive royalties, dividends, or interest.

Not only would the bill produce a great deal of hardship on individuals, certain tax-exempt organizations and holding companies but the Treasury Department would be required to process at least one-half million claims for refund. This would require a large addition to Treasury Department personnel, thus increasing the cost of government.

Another difficulty is that it might encourage nontaxable individuals to overstate the amounts of interest and dividends they received. By merely making overstatements in claims for refunds, they would be able to obtain refunds of a fixed percentage of the amounts they claim to have received. There would be no way for the Treasury Department to check overstatements made by individuals and the door would be wide open to fraud by taxpayers. Nontaxable indivduals might soon learn that it is profitable to overstate their interest and dividends. If this were done on a wide scale, taxpayers' morale and confidence in the tax system would be impaired. It is believed that the risk involved is substantial and that it would be dangerous for the Treasury Department to adopt a system which would be almost impossible to check.

The report of the Ways and Means Committee, which accompanies H. R. 4473, contains many misleading and, perhaps, inaccurate statements with respect to the manner in which the proposed withholding on dividends, interest, and royalties would operate. It is stated that the proposed regulation would require that information returns be filed by the payor, showing all dividend payments regardless of size and that the elimination of the present $100 limit on the reporting of dividends paid would mean a large increase in the amount of work required by the payor. This is incorrect. It is actually more work to the payor to report under the present $100 limit than would be the case if all the dividends were reported. This is because of the manner in which such reports are made. Paying agents have developed facilities for writing the required form 1099 at the same time the dividend check is written and it would be a very simple matter to file with the Government 1099's to correspond with every dividend check written. Under the present $100 limitation, it is necessary for the paying agent to re-sort and combine dividends so as to eliminate those which total less than $100.

The report speaks of the substantial administrative costs involved to the Government in determining the amounts of unreported income, in preparing deficiency notices and in actually collecting the tax. This raises the interesting question: On whom these administrative costs should fall? It is conceded that any system of personal-income taxation involves substantial administrative costs. When those administrative costs are shifted from the Government itself to the tax-paying public, the Government is generally the loser. This is because the administrative costs become an income-tax deduction to the taxpayer as an expense item and thus operate to reduce the amount of tax payable.

The report contains rather fantastic figures of estimated under-reporting, the total involved being over $3 billion. It must be remembered that the income tax is a self-assessed tax and if under-reporting of $3 billion of income can be substantiated, our system of personal-income taxation has reached the breaking point. It may also be noted that this alleged figure of $3 billion of unreported income is out of line with the claims for $323 million of tax revenue supposed to result from the withholding provisions.

The report speaks of the unfair disadvantage which is present in the existing law for those who report their income accurately. This proposal is one which would penalize those who owe no tax in order to reach the few who omit interest and dividends either through deliberate evasion or forgetfulness. All other provisions of the income-tax law penalize the guilty. This provision would penalize the innocent. This is an incorrect philosophy of tax administration.

The House committee report tries to make the procedure for withholding and mechanics of treatment by the taxpayer seem easy and simple. Unfortunately, the actual practice under current business operations is considerably more complicated than the authors of the report realize. The taxpayer, in making his return, will not always have solely interest on which the tax has been held. There is no withholding on Government bond interest, interest on bank accounts, etc. Consequently, the return must provide for two classes of interest; that on which the tax is withheld and that on which the tax has not been withheld. It thus becomes necessary for the taxpayer to keep an accurate set of books so that his return can properly reflect the true situation. It seems entirely likely that the same carelessness which now results in under-reporting will cause the taxpayer to treat all his interest received as being subject to withholding, with the result that larger credits for withholding will inadvertently be taken than are justified. Certainly, the administrative cost to the Government in untangling these careless or deliberate errors would be just as great as the administrative costs of preventing the errors in the first place. There is no simple, easy, foolproof method of a withholding tax on interest and dividends.

It is interesting to note that Government bond interest is exempt from withholding. Is this intended to discourage the faithful reporting of interest on

Government bonds? Or is it a recognition of the administrative cost (this time to the Government) involved in the proposed withholding procedure? It is alleged that most of the deliberate evasion, forgetfulness, or carelessness is on the part of the smaller taxpayer. Is it not true that Government E bonds and bank-savings accounts are the principal sources of interest income to these smaller taxpayers? If the proposed withholding procedure is so complicated and difficult to administer in these situations where probably the bulk of under-reporting occurs, it hardly seems justifiable in other situations.

The withholding plan in any form should be rejected.

COLLAPSIBLE CORPORATIONS

The bill attempts to deal with an alleged abuse of the use of collapsible corporations. Proper administration of existing laws should be relied upon to reach any improper transactions in this field. This feature of the bill should be rejected.

SALE OF PROPERTY TO A CONTROLLED CORPORATION

The bill would deny to individuals the privilege of selling property directly to a corporation owned by them, except under penalty conditions. There would be no bar upon the sale of property to a third person who then could sell to the corporation. Any abuses connected with the sale of depreciable assets to closely held corporations would seem to be controllable through existing powers of administration, particularly with regard to depreciation allowances to corporations.

SALE OF TAXPAYER'S RESIDENCE

The provision of the House bill relating to capital gain from the sale or exchange of a taxpayer's principal residence is a highly desirable step in the right direction.

COAL ROYALTIES

The House bill provides for the taxation of coal royalties in the same manner as timber royalties have been taxed for a number of years. The section is designed to remove a tax discrimination which has become increasingly inequitable with each rise in the tax rates.

Coal royalties should be treated as proceeds of the sale of capital assets. Benefits of such change would extend to all coal lessors.

We commend the provision.

NEEDED MODIFICATIONS

Tax-exempt organizations

The chamber has long maintained the position that:

"No form of lawful enterprise should be favored by Government over any other form, and each, whether cooperative or individual, whether in single units or multiple units, should stand on its own merits with protection from unfair competition and free from tax exemptions and other public subsidies."

In testimony before congressional committees, chamber witnesses have repeatedly stated that the special tax treatment and privileges now extended to cooperatives are so broad as to expose other businesses to unfair and destructive competition at their hands.

Now that the favorable position, under income, estate, and gift taxes, so long enjoyed by educational and charitable organizations, has been curtailed in the Revenue Act of 1950, the tax favoritism available to cooperatives is even more unjustifiable.

APPENDIX I

GENERAL SALES TAX

The relative advantages of applying a general sales tax at the retail level and at the manufacturing level may be summarized as follows:

AT THE RETAIL LEVEL

(1) It could be an exposed tax, being collected from the consumer as an additional item at the time of sale. It should make the public more conscious and critical of Government spending. This has not been fully accomplished in respect to withholding of personal income taxes from wages, nor in respect to the exposed

retail sales tax in some 30 States and 100 cities. Much can be said as a matter of principle in favor of exposing all taxes to voters.

Congress could pass a concealed retail sales tax, as some States have done, by imposing it on the retailer without mandatory passing on and with no stated bracket system for collecting it. The temptation to do this may be strong. The struggle has been to keep retail sales taxes exposed. New York City, to cite an instance, has both an exposed 2 percent sales tax and a concealed one-tenth percent gross receipts tax.

(2) An exposed retail sales tax will avoid the possibility of pyramiding by the retailer, simplify price fixing, and assist in keeping the tax out of cost-of-living indexes, thus limiting its influence upon wage increases.

(3) A retail sales tax would have the advantage of bringing in large revenues at a low rate. It also would permit the continuance of some manufacturers' excise taxes on selected items. Existing manufacturers' excise taxes are currently estimated to yield $4 billion on liquor and tobacco and another $2 billion on gasoline, oil, autos, radios, refrigerators, sporting goods, business machines, photographic apparatus, matches, and revolvers. Presently, at the retail level there is a Federal tax on furs, toilet preparations, jewelry, and luggage, which at the 20 percent rate is expected to produce $430 million.

(4) While there is likely to be evasion of a retail sales tax to the extent of almost 15 percent because of the many small retailers (90 percent are small single stores doing 40 percent or more of the sales) a retail sales tax would avoid the complicated licensing system and the decisions as to what is the last step in manufacturing.

(5) A final advantage of a retail sales tax is the absence of tax content in retail inventories, the avoidance of accusations of profiteering if the tax is imposed without floor-stock impositions, and the avoidance of retail-inventory losses if the rate is reduced without floor-stock credits.

AT THE MANUFACTURER'S LEVEL

(1) Evasion would be more difficult and the cost of collection would be less. There are 10 times as many retail outlets as manufacturers—approximately 2,500,000 retailers, including garages, restaurants, and manufacturers who also sell at retail, compared to 300,000 manufacturers. Many retailers are seasonal, occasional, or otherwise temporary operators. Many are very small and located out of the centers of population.

(2) The whole principle of sales taxes would be easier established at the manufacturer's level, particularly in respect to its application to processed food and clothing, without exemptions. The essence of a Federal sales tax is breadth of application. This should be more acceptable at the manufacturing level.

(3) The retail sales tax field has already been preempted by the States and cities. To impose now an exposed Federal tax would greatly increase their nuisance. It is not practical at this time, if it ever was practical, for the Federal Government to take over the field and share the income with localities which now use various rates depending on their needs.

(4) While the Canadian tax law is somewhat complicated, largely due to exemptions, it has been a satisfactory revenue producer since 1920. At an 8 percent rate since 1936, it is producing in Canada about two-thirds of the revenue of its personal income tax and about two-thirds of the revenue of its corporate income tax, each of which, like ours, usually produces similar amounts. The complication of the law, the equitability of the tax, pyramiding, and the cost of collection apparently are not sources of serious complaint from any interests in Canada.

There is reason to believe that with exemptions of food and medicine, a manufacturer's sales tax would yield approximately $750 million for each 1 percent in the rate and a retail sales tax about $900 million for each 1 percent in the rate. The rate of either tax, of course, would be influenced by the new revenues which might be obtained from selective excises.

APPENDIX II

TECHNICAL AND ADMINISTRATIVE AMENDMENTS

A supplemental statement urging the inclusion in any forthcoming revenue measure of a number of needed technical and administrative amendments to the revenue laws, including changes in the Excess Profits Tax Act, is being submitted for inclusion in the record of the hearings. The more important of these recommended amendments will be referred to in the oral statement.

TECHNICAL AND ADMINISTRATIVE AMENDMENTS

The following represent a few of the necessary technical or administrative changes which should be considered at the present time.

REPLACEMENT OF LIFO LIQUIDATIONS

During the early months of World War II, taxpayers using the LIFO inventory method found their taxable incomes artificially inflated by the unavoidable depletion of their base stocks of materials then in short supply, which would have to be replaced after the war at prices much higher than those at which they had originally been acquired. As part of the Revenue Act of 1942, the Congress provided for relief in this situation in the form of certain inventory adjustments defined in section 22 (d) (6) of the Code. Prior to the enactment of Public Law 919 last January, the right to these adjustments was available only where the taxpayer had made a replacement of previously depleted stocks by December 31, 1950.

Before this permissible replacement period had ended, the Korean war, with its various effects on commerce, and on the supply of many raw materials in particular, had made replacements impossible in certain instances, and had also forced new inventory liquidations. By Public Law 919, Congress accordingly extended the time within which World War II liquidations might be replaced, and also provided similar treatment for current liquidations if replaced by the end of 1955.

Unfortunately, these two provisions of Public Law 919—that extending the replacement right for World War II liquidations, and that establishing rights respect to current liquidations and subsequent replacements—were not properly correlated. This lack of correlation is attributable to the preexisting rule that replacements are to be attributed in all cases to the most recent liquidations not already replaced, and to the Public Law 919 termination date on World War II replacements of December 31, 1952.

The effect of this oversight maybe illustrated by the following example. A particular taxpayer, who at the outbreak of the Korean war had not completed his replacements of World War II liquidations, suffers further inventory depletion in the latter half of 1950 and throughout 1951. During 1952 he is able to effect a considerable amount of replacements, and during 1953 he is able to bring his inventory up to the pre-World War II level. He nevertheless loses the benefit of the Public Law 919 extension of World War II replacement rights because the 1952 replacements must be alllocated to 1950 and 1951 liquidations, and replacements in 1953, although within the period during which Korean liquidations might be replaced, are too late to be used as World War II replacements.

Congress certainly did not intend to deny the benefit of its extension of the date for replacement of World War II liquidations to those taxpayers most in need of it—those who now, because of the defense program, are not even able to maintain inventories, much less rebuild them.

This situation should be corrected by making December 31, 1955, the termination date for replacements of World War II as well as current liquidations.

OBSOLESCENCE DEDUCTION ON AIRCRAFT EQUIPMENT

Since the end of World War II the commercial airlines have generally had two major change-overs in the type of airplanes and related flight equipment used for passenger transportation service. These changes were dictated by the impact on the industry of the extraordinarily high rate of technological progress, resulting in the development of more economical, faster, and safer planes, and the consequent obsolescence of older planes. In the next few years the development of jet and turbo-jet aircraft will without doubt bring about the obsolescence of the DC-6's, Stratocruisers and Constellations which now constitute the first-line equipment, and that change-over will be the most complete and radical yet experienced.

In order to maintain their fleets in operation with the maximum of safety and the minimum of interruptions, the airline companies are required to keep on hand at all times certain stocks of parts and assemblies—ranging from spark plugs to landing gear—which can be quickly placed in flight service in lieu of parts requiring replacements, repair, or inspection. Although these parts are interchangeable as between different individual planes, the major portion can be used only on the single type of plane or engine for which they were specifically designed. They, too, therefore, have an extraordinarily high rate of obsolescence, and one which is equal to the rate of obsolescence of the plane to which they pertain.

These stocks of parts now held by the industry have an aggregate dollar value in excess of $81 million. This figure is increasing sharply.

Legislation is required so that the airlines may write off the costs of these stocks over the lives of the planes to which they relate, instead of being required to deduct substantially the entire cost as a loss in the last year of service. This would not only bring about the recognition of an obsolescence factor which is clearly present, but would make for a clearer reflection of income in the charging of the costs of the stocks ratably over the entire service period. The proposed treatment is in accord with the method of accounting recognized by the Civil Aeronautics Board.

The necessity of legislation is occasioned by the refusal of the Bureau to accept the principle of such a write-off, notwithstanding that obsolescence is expressly mentioned as a basis for a ratable deduction of cost by section 23 (l) of the Internal Revenue Code. The theory underlying the Bureau's position in this connection, and the limits of its position, are not entirely clear. It does accept the obsolescence factor in determining the useful life of the planes themselves. It does also in determining the life and providing for the write-off of the cost of the stocks of certain of the so-called "assemblies." But it does not admit that the rule governing these practices extends to stocks of parts in general.

The only difference between the "assemblies" on the stocks of which the write-off is allowed, and those parts on which it is not allowed, is that the former are generally somewhat larger and more complex. This rule-of-thumb physical distinction is certainly not such a difference as should be made the basis for allowing or disallowing an obsolescence deduction, or as the Congress has approved for such a purpose.

Furthermore, the parts and assemblies in stock at any given time are making a contribution to the maintenance of service which is equally as vital as that made by the parts and assemblies then on the planes, on which an obsolescence allowance is of course recognized. Without either group of parts, the carrier's service could not be continued with the required regularity and safety. Those parts on the plane are subject to greater physical deterioration, but as this factor is not the basis of the allowance in either case because the obsolescence factor is generally the more severe, this difference is immaterial.

Litigation of this issue with the Bureau is not a satisfactory solution. The airlines not presently enjoying the allowance which the amendment would recognize failed to press their rights to it in past years when the amounts invested in such stocks were small, and today are forestalled from asserting such a right because to do so involves a change from present accounting methods for which the law requires the Commissioner's prior approval.

Moreover, the practical needs of the air transport industry are such that a spreading of this cost cannot be achieved by a gradual liquidation of any such stocks over the last few years of their use. Being maintained generally at levels no higher than required for purposes of the necessary ready availability, they cannot be substantially reduced until the actual date of the change-over which renders them completely obsolete in the hands of that company.

MEDICAL EXPENSE DEDUCTION

Section 23 (x) of the Code, as added by section 127 of the Revenue Act of 1942, allows a limited deduction by individuals for amounts expended for medical care. The term "medical care" is defined to include amounts paid, according to the statute, for the "diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body," and, according to the pertinent finance committee report, for the alleviation of a physical defect.

In making such amendment it was obviously intended that the term "medical care" be broadly construed. Recently, however, the Commissioner has ruled that the cost of a wheelchair attendant necessitated by the loss of use of the lower limbs from poliomyelitis does not constitute a medical expense within the meaning of the statute. That particular case involved a disability incurred in the course of service in World War II, and has resulted in the necessity of the taxpayer contesting before the tax court a proposed deficiency amounting to $77.

The constant service of an attendant is often necessary by reason of the loss of sight, or of limbs, paralysis, or other severe afflictions. It is clear that the Congress did not intend to discriminate narrowly against expenses for this class of assistance.

A clarifying amendment is therefore appropriate, and it should be made retroactive for the period during which section 23 (x) has been in effect.

EXCLUSION OF CAPITAL GAINS FROM SECTION 102 INCOME

Long-term capital gains should be excluded from the income subject to the penalty tax on corporate accumulations imposed by section 102 of the Code.

Long-term capital gains, when realized by a corporation, are now taxed at a rate of 25 percent. Under H. R. 4473 as passed by the House, they would be taxed at a rate of 28¼ percent. In both instances, this is equal to the maximum rate at which the same income would be taxed if realized directly by an individual. As the purpose of the section 102 surtax is to penalize the accumulation of corporate earnings retained with the purpose of avoiding individual surtaxes, it is clear that there can never be any justification for applying the tax to this type of income.

Moreover, under existing law, long-term capital gains are not subject to the special tax imposed on the undistributed net income of personal holding companies. It is not believed that ordinary corporations should be treated more severely. The adoption of the proposal would not prevent long-term capital gains from being considered in determining whether earnings were allowed to accumulate in excess of the reasonable needs of the business.

H. R. 6712, which passed the House during the second session of the Eightieth Congress, contained such a provision.

LUMP SUM PAYMENT OF CUMULATED DIVIDENDS

Suppose X, an individual, owns 1,000 shares of $6 cumulative preferred stock. For one reason or another, he receives no dividends for 4 years. Suddenly, 5 years' dividends, or $30,000, are paid in a lump sum.

Having received all the income in 1 year, X will be taxed under the present law about $13,000. If he had received the dividends regularly at the rate of $6,000 a year for the 5 years, his tax for the 5 years would have amounted to only about $6,000 in the aggregate. In the one case he has only $17,000 left of his $30,000 dividend, and in the other, $24,000. Obviously, it is harsh to treat X as a $30,000-a-year man when he is really only a $6,000-a-year man.

The same unfortunate result follows under existing law from the lump-sum receipt of several years' back bond interest.

When it is remembered that the taxpayer in these cases is frequently a widow, a retired person, an estate, or the beneficiary of a trust, who may already have suffered considerable hardship from the failure to receive the income periodically, without compounding the misfortune through the tax laws, the result is unduly harsh.

The solution is an easy one. In fact, it lies ready to hand—limit the tax for the year of receipt to what it would have been if the income had been received periodically. This is what section 107 of the Internal Revenue Code already does in the case of back pay, lump-sum payments for personal services, and income from patents or copyrights, and no reason exists why this treatment should not be extended to cumulative preferred stock dividends or defaulted bond interest.

Retroactivity to 1945 is essential. The subject was first broached at that time. Taxpayers should not be penalized because of the delay by Congress in considering so-called technical and administrative amendments.

DISTRIBUTION OF SECURITIES HELD MORE THAN 10 YEARS

There are numerous situations where, for sound business reasons, corporations should divest themselves of stock or securities in other corporations, but cannot do so because of the disastrous tax consequences which would result to them or their shareholders from sale or distribution, and the destruction of values which would often follow as a consequence of forcing a liquidation of holdings to meet tax liabilities. The stock or securities may be that of a wholly owned subsidiary which ought to be separated from its parent. Or they may represent an investment no longer appropriate, or one which imposes undue supervisory responsibility on management at a time when it should be devoting its energies to the taxpayer's own operating business. It is imperative to facilitate such divestitures. To provide that they can be made tax-free will not injure the revenue, since otherwise they will not be made at all and, through proper allocation of basis, a tax will ultimately be obtained from the distributees.

The code should, therefore, be amended to permit tax-free distribution of stock or securities so held, with the same tax consequences to the distributees as would exist upon the receipt of a nontaxable stock dividend, i. e., an allocation of basis. To make certain that no anticipatory division could be employed, it would be appropriate to limit such treatment to a distribution of stock or securities held by the distributing corporation for a minimum of 10 years.

EXEMPTION OF INCOME EARNED ABROAD

Section 116 (a) of the Internal Revenue Code, which provides for the exemption under certain circumstances of income earned outside the United States, was intended to relieve American citizens who go abroad in the pursuit of a trade or profession from the burden of double taxation on their earnings, and also to provide an incentive for foreign employment by exempting such earnings from Federal income tax. Such an incentive is especially necessary today and the purpose of the incentive has a vastly increased importance.

Under present law, however, the exclusion fails to achieve its purpose in two respects. In the first place, the exclusion is allowed only where the taxpayer has been resident abroad for the entire taxable year. The Treasury has rightly suggested on several occasions that there is no reason not to allow the exclusion from the date that foreign residence is first assumed. This would end the present arbitrary denial of the exclusion for the first and last few months of foreign residence.

In the second place, the courts have construed the term "residence" as being substantially equivalent to "domicile", even in the case of an employee engaged in bona fide foreign service for his employer. For example, they have refused to recognize foreign residence where the taxpayer left his family in the United States, or gave other evidence of an intention to return to the United States at some time in the future.

The interpretation misconstrues the purpose of the exclusion. The people supposed to be benefited were not expatriates who had renounced the United States forever. They were the armies of managers, technicians, and skilled workmen who were induced to commit themselves for 18 to 36 months abroad. In many instances the nature and location of their work and the lack of adequate educational facilities do not permit them to take their families. In practically no instances do such men have an intention on their original departure of making their home abroad permanently, even though they may renew their contracts many times and stay abroad for years. Clarification is apparently necessary in order to make certain that the exclusion is available to such employees who are living abroad by reason of bona fide employment, for the period they are absent from the United States.

GAIN TO EMPLOYEE ON RECEIPT OF TERMINATION PAYMENTS

Action is required to relieve the hardship resulting from the present inapplicability of the capital gains provisions of the Internal Revenue Code to certain payments received by employees or retired employees in liquidation of continuing rights arising out of a long-continued period of employment.

Employment contracts frequently provide for payments beyond the employment period, based upon a percentage of future profits of all or part of the employer's business, or a percentage of gross receipts from the exploitation of some particular devices, productions, ideas, or other property, for which, or for the development of which, the employee was largely responsible. Upon termination of his employment, the employee may not wish to have his future income depend upon the hazards of a business with which he is no longer connected. He may prefer a lump-sum realization of his essentially contingent rights. The employer will also in many cases desire to liquidate its contingent liability. Since, however, the employee will be receiving the commuted value of several years' income in 1 years, the concentration of income will result in a prohibitive tax cost, unless the profit realized is treated as a long-term capital gain. The code should be amended to make certain that such treatment will be accorded, for the same basic reasons exist for such treatment as in other cases where it is available, i. e., for realization of several years' income in a single year. The justice of this approach has already received congressional approval in the pension field. It is provided in section 165 (b) that a lump-sum settlement with a beneficiary shall be treated as capital gain rather than ordinary income. Even in the type of case under discussion, no uncertainty would exist if, for example, the employee's efforts gave him a property right in a particular patent which, upon termination of his employment, he sold to his employer. It should be immaterial whether the sale or release occurs prior to or after the actual termination of employment.

REDEMPTION OF STOCK TO PAY DEATH TAXES

Section 209 of the Revenue Act of 1950 added to the code a provision—section 115 (g) (3)—which in appropriate situations permits the stock of a closely held corporation to be redeemed from the estate of the decedent proprietor without the estate incurring any risk of the imposition of a dividends tax on the distribution. This provision was intended to make such distributions possible as a means of paying estate taxes without the highly inequitable and undesirable losses of value and of control involved in the forced sale of family businesses. As the provision now stands, however, it contains certain arbitrary limitations on its application which have the effect of denying relief in some situations where it is most needed.

In the first place, the provision applies only to distributions "within the period of limitations for assessment of estate tax * * *." Thus it has been of no benefit to those executors of estates already in the process of administration who, before the enactment of the 1950 act, had conscientiously proceeded to discharge the estate tax liability with borrowed funds, but were still faced with the basic problem of discharing the resulting loan.

Furthermore, the provision is limited to situations in which the decedent's business was operated through a single corporation only. Where the estate consists largely of the stock of two or more closely held corporations, the same problem exists.

Section 115 (g) (3) should be extended to the two situations just indicated. This change should be effective as of the date of enactment of the 1950 act.

REORGANIZATION IN THE FORM OF "SPIN-OFFS"

The House, during the Eightieth Congress, and the Senate, during the Eighty-first Congress, each approved a provision which would have recognized the nontaxability of corporate reorganizations taking the form of "spin-offs." A "spin-off" occurs when a part of the assets of an existing corporation are transferred to a new corporation and the stock of the latter is distributed to the stockholders of the existing corporation. A "spin-off" is distinguished from a "split-up," the latter consisting of a transfer by an existing corporation of all of its assets, part to one new corporation and part to another, the stock in the new corporations being distributed to the shareholders of the existing corporation in complete liquidation.

Under existing law a "split-up" may be carried out without recognition of gain or loss. There is, however, no substantial difference between a "spin-off" and a "split-up" or the purposes for which they may be used. Only where some technicality of corporate law may impede the use of a "split-up" is it necessary for corporations to resort to "spin-offs", but in this situation it is economically unsound to prevent the one type of reorganization which can accomplish the division of an existing business into smaller units.

The principle which was approved by each of the two Houses of Congress within the past 3 years should be given effect by the inclusion of "spin-offs" as a proper type of corporate reorganization within the ambit of section 112 of the code.

NET OPERATING LOSS DEDUCTION FOR 1951–53

Prior to the Revenue Act of 1950, the Internal Revenue Code recognized a limited right of averaging income over a 5-year period. By virtue of this right taxpayers could reduce their taxable income each year by the aggregate of their "net operating losses" during each of the 2 years immediately before and immediately after the taxable year—i. e., by a 2-year "carry-forward" and a 2-year "carry-back."

When H. R. 8920, the bill which was later to become the 1950 act, was under consideration in each House, notice was taken of the fact that small and new businesses were peculiarly subject to fluctuating incomes. It was further reasoned that these types of businesses in particular and venture capital in general would derive a real stimulus from an extension of the averaging period, and also from increased emphasis on the carry-forward (see H. Rept. No. 2319, p. 59, and S. Rept. 2375, p. 56, 81st Cong., 2d sess.). Both revenue committees accordingly recommended a measure intended to accomplish these two ends by extending the 5-year averaging period to 7 years, comprising a new 5-year carry-forward and a 1-year carry-back. This measure was eventually enacted as section 215 of the 1950 act without apparent opposition from any quarter.

Contrary to the general understanding when the 1950 changes were before the Congress, the literal terms of the provision in which they were embodied do not make the 7-year averaging period actually available to taxpayers until 1955.

Indeed, during a substantial interim period they have the effect of reducing the preexisting averaging period from 5 to 4 years. Moreover, they effect no increase in the carry-forward until 1953.

As an illustration, under the terms of the 1950 amendment, taxpayers are permitted to set off against their income for the current year—1951—only whatever net losses they may have sustained in the years 1949, 1950, and 1952, and against their income in 1952, only losses in 1950, 1951, and 1953. For a tabular representation of the inadequate articulation of the 1950 changes with prior law, see the attached schedule.

At a time when taxpayers are faced immediately with the severe burden of sharply increased surtax rates and excess profits taxes, no justification for a current reduction in the averaging period can be found in the prospect that taxpayers still in existence at some time several years in the future will then enjoy the benefit of an extended period. The principles of a 7-year averaging period and of a longer carry-forward, which are conceded to be desirable for 1955 and later years, are equally appropriate today.

The anomaly of this situation is most evident in connection with the recent enactment of the excess profits tax. Both revenue committees, in formulating the relief provisions under that tax, acted on the stated assumption that there were several new rules reducing the need for such relief, relative to that under the old excess profits tax, and that one of these new rules was "the substitution of a 5-year carry-forward and a 1-year carry-back of * * * net operating losses for the 2-year carry-forward and the 2-year carry-back used under the World War II law" (H. Rept. 3142, p. 16, and S. Rept. 2679, p. 18, 81st Cong., 2d sess.). The fact was, however, that under the actual terms of the 1950 amendment the averaging period for these losses had been reduced, rather than increased, for 3 of the 4 years for which the excess profits tax was enacted (1950, 1951, and 1952), and merely maintained at its previous extent for the fourth year (1953). The increase in the averaging period which was seen as easing the impact of the new excess profits tax will not actually become effective until after the excess profits tax expires.

An amendment could minimize this interim inequity by extending the right to carry forward 1948 and 1949 losses to 4 years instead of 2. This would have no effect on deductions presently allowable for years prior to 1951, or subsequent to 1953, when the benefits of the 1950 changes will first begin to make themselves evident. It would merely bring about a gradual transition to the new 7-year averaging principle already established, by making a 5-year averaging period (i. e., equal to that under the old law) available for 1951, and a 6-year period available for 1952 and 1953.

Although a complete correction of the inequity would require that such an amendment also apply to years prior to 1951, its application has been limited so as not to necessitate refunds for years for which returns are already filed. Moreover, the need for correction with respect to 1951 and subsequent tax years is more acute by reason of the higher tax rates applicable to such years, and because 1946 and 1947 losses will already be largely used up by being carried back into the high-profit World War II years.

Net operating loss carry-forwards and carry-backs for taxable years from 1946 to 1956, inclusive, as allowed by existing law and by the proposed amendment

Carry-forward allowed from	Taxable year	Carry-back allowed from
1944–1945	1946 [2]	1947–1948
1945–1946	1947	1948–1949
1946–1947	1948	1949
1947–1948	1949	1950
1948–1949	1950	1951
(1948)–1949–1950 [1]	1951 [3]	1952
(1948–(1949)–1950–1951 [1]	1952 [3]	1953
(1949)–1950–1951–1952 [1]	1953 [3]	1954
1950–1951–1952–1953	1954	1955
1950–1951–1952–1953–1954	1955	1956
1951–1952–1953–1954–1955	1956 [4]	1957

[1] The years shown in parentheses are not permissible sources of loss carry-forwards under present law, but would be so under the proposal.

[2] For all years prior to 1946, beginning with the year 1941, the averaging period is the same as for the year 1946.

[3] These years would be affected by the proposal.

[4] 7 years is also the averaging period for all years subsequent to 1956.

EMERGENCY AMORTIZATION

Section 124A permits the amortization of facilities the construction of which was begun prior to the beginning of the conflict in Korea. Some have questioned the propriety of this.

Before the fighting began in Korea, aircraft manufacturers, for example, had begun to expand their facilities in response to military demands. In turn, suppliers of aircraft manufacturers had begun to increase their capacity, again to meet emergency demands. There is no sound basis for treating these leaders in the current industrial expansion on a basis different from those whose participation in the expansion program began at a later date.

Under section 124A, the amount of the cost of a facility which is attributable to construction prior to January 1, 1950, is not subject to the amortization deduction. This goes further than to afford adequate protection against the certification facilities which cannot properly be regarded as related to the emergency. Actually, it creates an inequitable situation. The companies most directly related to military procurement who had the foresight to expand early for the defense program are denied the right to write off the cost of these facilities during the period they are reasonably certain to produce income. To some extent a premium is placed on postponement of necessary expansions.

There are two ways in which our committee feels section 124A should be changed. The changes recommended have to do with the determination of the percentage of certification and with the question of a further acceleration or "compression" of amortization in certain circumstances.

The percentage of certification is now based in part on the estimated post-emergency usefulness of the facility. Thus, for example, if it is estimated an emergency facility has no post-emergency utility and there is the greatest possible risk in the investment, certification may be for the entire cost. If it is estimated the entire plant will have post-emergency utility and there is little or no risk in the investment, certification may be denied entirely. If the plant expansion is estimated to be 50 percent useful after the emergency, certification may be for 50 percent or less, depending on the evaluation of the investment risk. The trouble with this is that no one can accurately predict post-emergency utility and whether earnings will ever be produced by the facilities beyond the emergency period—or for that matter during all or a substantial part of this period.

Considerable time and effort is being spent in the delegate agencies on the question of the percentage of certification in terms of future usefulness. This is unfortunate because it is largely a futile effort carrying little assurance of equitable results and, possibly more important, because it is delaying the issuance of many certificates which in turn is delaying construction. Some companies with limited working capital due principally to greatly increased inventories are genuinely concerned about borrowing money for plant expansions without assurance of amortizing the cost against the earnings to be produced.

The answer to this difficult problem is to determine the percentage of certification solely on the basis of the present emergency military and essential civilian need for the product of the facility. The Senate recognized this in an amendment to the 1950 act but the provision was deleted in the conference committee.

The statute is not entirely clear on the question of percentage certification. The doubtful language requires a determination of the portion of a facility "attributable to defense purposes." Administrative interpretation has been that the percentage should be based on both present emergency utility and post-emergency utility, although there is some indication other considerations have been taken into account in an effort to achieve fair results. The legislative history of the provision indicates that the language was intended to require the determination only of the use of the facility during the emergency period. General principles of fairness and considerations of sensible administration suggest that the interpretation indicated by the legislative history should be made express in the statute.

The second suggested change is forward looking. Section 124A, like section 124, sets an arbitrary 60-month amortization period. Under 124A, as under section 124, a taxpayer is given the right to elect amortization and, subsequently, to abandon it in favor of the depreciation deduction. But section 124A differs sharply from old section 124 with respect to amortization in the case of termination of the emergency or termination of the emergency need for a certified facility. In such circumstances, section 124 provided alternatives to the 60-month amortization period. The taxpayer was permitted to use a shorter period in case the emergency terminated before the end of 60 months or the facility became unnecessary for defense purposes during the emergency. In the case of an election of either alternative, taxes for prior years were to be recomputed so as to adjust the difference in the deduction.

Such provisions are needed in the present law. The taxpayer should be permitted to recover the cost of producing income before the application of the tax. If termination of the emergency terminates the usefulness of an emergency facility, the entire cost of the facility is a charge on the income produced during the emergency period. This fundamental principle is overlooked in the present statutory provision.

Even more important, in view of the likelihood of a prolonged continuation of the emergency, provision should be made for a further acceleration of amortization of facilities which become unnecessary and idle within the period of the emergency. For example, industrial expansion in its early tooling-up stages requires tremendous increases in the production of machine tools and other machinery. For this purpose great plant expansion has been taking place. But the history of World War II and earlier emergency periods indicates that even before general defense production reaches full proportions the demand for machine tools and many other facilities will have been met; sales will slacken and then sharply decline.

Provision should be made, as in section 124, for "compression" of amortization if (1) the emergency period actually ends before the 60-month period, or (2) there is a determination by the certifying authority that the certified facilities are no longer necessary in the interest of national defense.

EMPLOYEE STOCK OPTIONS

Under section 130A of the Internal Revenue Code, as added to the code by the Revenue Act of 1950, an employee who holds a "restricted stock option" from the employer corporation may exercise his right under the option to purchase stock in the corporation without incurring an income tax liability until he later disposes of the stock. The law defines a "restricted stock option" in a way which is generally intended to include options granted as employee incentive devices and to exclude options merely calculated to permit the holder to realize income in the form of capital gain.

One element of this definition excludes from the category of "restricted stock options" any options which by their own terms are subject to assignment, whether actually assigned or not.

This provision works an unnecessary hardship on employees who were granted assignable options prior to the adoption of the 1950 act, but who have not assigned them and have never intended to do so. The parties may have failed to include in the option a prohibition on assignment merely because it was thought to be unnecessary, but today they cannot modify the option to add such a prohibition without causing the option to be treated as one originally granted at the time the modification is effected.

Section 130A should be amended to permit options granted prior to the 1950 act to be so modified without being treated as new options.

AMENDMENT OF SECTION 131(F)

Section 131(f)(1) of the code allows a domestic corporation a credit against the United States tax for taxes paid other countries by a foreign corporation from which it receives dividends, but only if the domestic corporation owns a majority of the voting stock of the foreign corporation .

This restriction on the availability of the credit is without justification. The credit is limited in any event to that proportion of the foreign taxes paid which the amount of the dividends received by the domestic corporation bears to the profits with respect to which the taxes are paid. Thus the credit is otherwise made to be in proportion to the relative interest held in the foreign corporation. The effect of the restriction is simply to deny the lesser credit which would be allowed to noncontrolling stockholders if the restriction were not present.

In many instances, foreign law or business conditions or sound policy dictate large local participation in foreign enterprises. In others, two or more domestic corporations desire to enter a foreign venture on an equal footing. The credit should be extended at least to all situations in which the domestic corporation owns more than 10 percent of the foreign corporation.

This follows a recommendation made last year to the House Ways and Means Committee and to the Committee on Finance by Secretary Snyder. It is in accord with the policies of the administration and there is no reason to postpone action upon it.

For the same reasons, a relaxation is required of the provision in section 131 (f) (2) limiting the allowance of a credit for foreign taxes paid by a foreign subsidiary of a subsidiary to cases where the top subsidiary owns 100 percent of the bottom subsidiary. A 50 percent minimum in this situation would be ample.

CONSOLIDATED RETURNS

For the "privilege" of filing consolidated returns, section 141 (c) of the code exacts a penalty of a tax of 2 percent, in addition to normal tax, surtax, and excess profits tax. Theoretically, this additional 2 percent is designed to neutralize the tax saving which results from the immediate advantages of consolidated returns: (1) The offsetting of one affiliate's losses against another's profits, and (2) avoiding the tax on intercorporate dividends and transfers of property.

But despite these immediate advantages, whether there is a long-range tax savings in most cases is doubtful. The corporation filing separate returns can utilize its losses under the carry-back and carry-forward provisions of the code; and in the transfer of property between corporations filing consolidated returns, not only is realization of gain merely postponed, but the lower bases remains effective for all other purposes, including depreciation. In addition, consolidated corporations are allowed only one section 15 surtax exemption, and only one $25,000 minimum excess profits credit. For purposes of the excess profits credit based on income, consolidated corporations are required to use a consolidated base, and for purposes of the credit based on invested capital, they must aggregate their capital and subject themselves to the lower rates applicable to larger businesses.

Nevertheless, whether corporations using the consolidated return are not paying more than the privilege is worth is not or should not be the determinative point. If it is believed that consolidated returns result in a fair reflection of group income, there is no justification for superimposing a penalty tax for the "privilege" of using the appropriate method of income computation. It would, of course, be difficult to maintain that consolidated returns do not result in a clear reflection of income, in the light of the number of occasions in the past in which the Congress has approved their use, and even in some instances, made such use compulsory.

The only just conclusion is that the 2-percent tax should be repealed. If, however, for purely revenue reasons, this step is not feasible at the moment, the least that should be done is to authorize an annual election as to the use of the consolidated return.

Under present law, it has been left to the Treasury to fix the conditions under which eligible corporate groups might file consolidated returns. Heretofore the Treasury regulations have not limited the right of eligible corporate groups to elect a change from an individual return basis to consolidated returns. But they have made such an election binding for all subsequent years, unless new corporations are added to the group, except when in the opinion of the Commissioner some change in the Internal Revenue Code or Treasury Regulations makes the continued filing of consolidated returns less advantageous to "affiliated groups as a class." In the majority of years since 1941, when section 141 in its present form was first enacted, a new election has actually been permitted. The Treasury's decision has usually not been issued, however, until after the close of the taxable year affected, and in some instances not until after the due date for the filing of returns.

It is certainly not improbable that future changes in the tax laws and regulations will be sufficiently frequent so that consolidated groups will actually have the privilege of a new election substantially as often as they would under this proposal. The present system, however, places eligible corporate taxpayers in a position of uncertainty in which an election must be made not only without knowledge of how new tax legislation may change the consequences of the election, but also in complete ignorance as to whether the Treasury will consider the new laws or regulations as working to the disadvantage of "affiliated groups as a class," and thus as to how long the effects of the election will last.

Moreover, changes in the tax laws and regulations are not the only factors making for uncertainty as to the consequences of a consolidated return election. Many other governmental actions are, practically speaking, equally as important to the corporate taxpayers in making their decisions in this connection, e. g., new price and wage ceilings promulgated by the OPS and WSB, new public utility rates promulgated by Federal or State agencies, changes in Government programs involving procurement contracts, changes in renegotiation law or practice, etc. These actions not only may affect the consequences of taxpayers' decisions as to whether to file consolidated returns just as much as changes in the tax law, but are also just as much the responsibility of the Government and just as much outside taxpayers' control. It is clear that any requirement that consolidated return elections must bind taxpayers for subsequent years places them in the impossible position of having to predict the course of events outside their control.

If the 2-percent penalty must be retained as a means of offsetting the over-all loss of revenue believed to be involved in the use of consolidated returns, there is no basis for denying to taxpayers the right to make an effective election as to whether the privilege will be claimed.

SUPPLEMENT R TRANSFERS

Supplement R of the Internal Revenue Code provides for the nonrecognition of gain or loss in the case of certain property transfers pursuant to an SEC order in furtherance of the integration provisions of the Public Utility Holding Company Act of 1935. This treatment was provided because of the compulsory nature of the transactions, and the thought that recognition of gain or loss should, wherever possible, be postponed until a voluntary realization occurred.

Among the transfers covered by supplement R are those within a "system group." A "system group" is defined in section 373 (d) in a way which is intended to insure that the companies involved in the transaction are a group of closely related corporations. The test now used to determine the closeness of the relationship in section 373 (d) is the percentage of ownership of each class of stock other than stock which is preferred as to both dividends and assets. The percentage of ownership required is 90 percent.

As is the case whenever an arbitrary line is drawn, the establishment of a requirement of ownership of 90 percent of each class of stock may exclude a particular taxpayer from the benefits of supplement R although the group would be regarded in all other respects as involving closely related corporations. Thus ownership by corporation A of 90 percent of the total equity stock of corporation B may not qualify them as being members of the same "system group." For example, where, as in an existing situation, the equity stock of B consists of two classes—one of over $40,000,000 and one of about $15,000—and A, while owning 96.8 percent of the total equity stock owns slightly less than 90 percent of the smaller class, the two corporations, under a strict interpretation of the existing law, will not be considered members of the same "system group." Moreover, this would be true even though A owned 99 percent of the total equity stock and possessed 90 percent of the voting power of B.

A reasonable alternative to the existing test should be established to determine, as to any corporation in a chain, whether the chain is closely related. This might reasonably be done by requiring compliance either with the present test, or with one involving ownership of 95 percent of the voting power and 95 percent of the aggregate of all classes of nonpreferred stock.

PERSONAL HOLDING COMPANY AND FOREIGN PERSONAL HOLDING COMPANY

Because of widespread tax avoidance through the use of the so-called "incorporated pocketbook," Congress in 1934 and 1937 introduced the basic provisions of the personal holding company and foreign personal holding company surtaxes which continue as part of the Internal Revenue Code today.

The original stimulus occasioning the use of the "incorporated pocketbook" was the much higher level of taxation applicable to individuals in the middle and upper brackets than that applicable to corporations. The practice itself involved transferring assets—primarily securities—to a holding company, which would receive the income from them, pay taxes thereon at the relatively low corporate rates then in effect, and reinvest the balance. The tax on personal holding companies was intended to frustrate this avoidance of the individual surtaxes by levying an additional corporate surtax on the income of closely held holding companies to the extent such income was not distributed to its stockholders. The tax on foreign personal holding companies was intended to accomplish the same purpose with respect to corporations outside United States jurisdiction by taxing their United States stockholders on the undistributed corporate income in the same manner that they would have been taxed if such income had actually been distributed.

The personal holding company surtax should not apply to income which, if distributed, would not be taxable in the hands of the stockholder, and neither surtax should apply to income which the corporation may not or should not distribute by reason of certain other specified laws of the United States.

Insofar as these taxes as presently constituted apply to income which the proposal would exempt, they both go beyond the only purpose which they have ever been intended to serve—preventing the avoidance of individual surtaxes, and also impose an unnecessary and extraordinary hardship on innocent investors.

For example, the proposal would prevent the personal holding company tax from applying to income which, if distributed, would not be then taxable because received by an exempt charitable or educational organization, or by one who is exempt on such receipts under applicable provisions of United States tax treaties. It would prevent either tax from applying to income the distribution of which the Government has prohibited under the Trading With the Enemy Act of October 16, 1917, or the First War Powers Act of 1941, or on which the Government has asserted a lien prior to the end of the taxable year.

REPEAL OF SILVER BULLION TRANSFER TAX

Section 1805 of the Internal Revenue Code levies a tax of 50 percent of the proceeds from transfers of an interest in silver bullion. This tax originated as a part of the Silver Purchase Act of 1934. The tax was imposed to prevent speculation in silver arising out of the adoption of the silver program. It was not intended to produce revenues and, with sporadic exceptions, has never raised enough to pay the cost of administration.

The present effects of the tax are to prevent the operation in this country of a normal nonspeculative commercial market for silver and arbitrarily to penalize from time to time commercial users of that commodity.

The tax serves no useful purpose at the present time. It should be repealed.

EXCESS-PROFITS CREDITS

The basic problem under any excess profits tax is how to measure "normal" profits—which will not be subject to this particular tax. This is done, first, by the establishment of some general formulae or "credits," and, second, by the formulation of methods of specially accommodating such credits to the infinitely varying circumstances of business development. The latter methods are the "relief" provisions. To the extent that the credits are unrealistic or the relief provisions are inadequate, the excess-profits tax becomes merely a progressive, discriminatory, and confiscatory tax on normal profits.

The credits provided under the present excess-profits tax are clearly incapable of covering normal profits. The 85-percent rule, which the present bill would reduce to 75 percent, is, of course, explicitly directed at normal profits. Moreover, the methods of arriving at average base period net income before this percentage reduction is itself faulty.

Elimination of one of the 4 years in the base period is no more than necessary to cut out the height of the reconversion period. Many fiscal year corporations, it must also be remembered, will have 1945 experience reflected in their base period under this bill. It would be necessary to eliminate a second of the 4 years if it were desired merely to eliminate the eccentric abnormalities of 1945 and 1946.

The number and magnitude of the abnormalities affecting business in general during the past 5 years have been such that many firms will not show even 2 years of normal experience within this period. The least protection that could be afforded them would be to permit the use (as a "basement") of the average base period earnings under the old law—1936-39—adjusted for capital additions since 1939 and increased by 50 percent, for example, to adjust for the subsequent inflation. It is believed that as a matter of principle any taxpayer should be entitled as a minimum to the use of the same earnings credit which it used in 1945 under the World War II law. This is the credit to which it would have been entitled if the excess-profits tax had not been repealed. It makes no allowance for the tremendous price inflation which occurred in the meantime.

Furthermore, there are many taxpayers which unfortunately suffered declining earnings throughout the base period. Certainly they should be encouraged to restore their profits to the highest level of the base period, without confiscation or penalty.

The formula for the determination of the "base period capital addition," in taking the taxpayer's "last two taxable years" preceding its first excess profits taxable year as the period during which capital expansion will be recognized for this purpose, seriously prejudices the firm which has recently changed its taxable year. Such a firm might not get this type of credit for capital additions in more than 13 months instead of the 2 years which are generally contemplated.

An intelligent and fair selection of base-period years will eliminate many problems. 1950 should be included, for example, in the base period for the 1951 tax. There simply were no high profits in 1950 from the defense program. There were, however, in some cases, unusually high profits during 1950. A

15-percent discount of 1950 earnings might, therefore, be justified. But there is no justification for discounting the earnings of 1946, 1947, 1948, or 1949.

The earnings of 1 year during the base-period years are unquestionably the best measure available of "normal" profits, and should be used. In no other way can confiscation of normal nondefense earnings be avoided. And other adjustments discussed hereinafter are essential to exempt from the proposed tax normal profits resulting from growth, increased efficiency, expansion, and new products.

ADJUSTMENTS TO BASE PERIOD NET INCOME

Under the old excess-profits tax, for purposes of computing net income during the base period, casualty and abandonment losses were disallowed without regard to their "abnormality." Insofar as a taxpayer has sustained such losses in the base period, its experience in that period is obviously distorted from the "normal" in any reasonable sense, and there is no justification for arbitrarily prohibiting the exclusion of 15 percent of those losses, as the present law does. There is less justification and no logic whatever, in ruling that a taxpayer which has had a series of such losses can exclude none of them, which is the effect of the 4-year average limitation. There is also no justification in making the disallowance contingent upon the amount of the deduction exceeding 5 percent of the average base period net income. This is simply a discrimination between taxpayers on the basis of their size.

The purpose of the condition to the disallowance of "abnormal" deductions that they should be shown not to be a "cause" of an increase in the taxpayer's gross income is not clear. The committee reports on this provision incorrectly stated that it was also present in the old law. It would seem to have the anomalous effect of denying a casualty deduction to the extent that the taxpayer increased its income in future years through rebuilding a more modern plant than the one which was destroyed.

Another type of "abnormal" loss for which an adjustment should be, but is not, made is illustrated by the postwar experience of many businesses. For example, it was not uncommon for a business to lose money, or to make insignificant profits, during 1 or 2 or even 3 years following World War II, on contracts entered into ill-advisedly. Its "experts" on civilian business had not returned from the war and the "substitutes" were inexperienced. If the losses actually realized on business operations (even though the over-all business was not in the "red") exceeded losses actually realized on similar business operations over a 10-year period, they should certainly be disregarded in computing "normal" base-period earnings. As in the case of many other adjustments, this proposed adjustment will not be necessary, however, if 1950 is included in the base-period years and if 1 year is selected for the earnings credit.

PURCHASE OF ASSETS

The excess-profits-tax law should permit a corporation which has acquired all the assets of another corporation, the transferor corporation having been liquidated, to use the earnings experience of the transferred assets in computing its average earnings credit for excess-profits-tax purposes.

This privilege of using the earnings experience of another taxpayer has been heretofore extended, both under the World War II law and under the present excess-profits-tax law, only to cases involving the acquisition of assets in certain tax-free exchanges. Clearly, however, to a corporation using the average base period earnings credit, there is no proper connection between its basis in operating assets acquired from another corporation and its right to use the earnings experience of those assets. It is equally as logical for the acquiring corporation to enlarge its earnings credit upon the taxable purchase of the productive facilities of another corporation as it is for it to do so where it acquires such facilities at the transferor's tax basis.

Admittedly, some problem might be involved if it were proposed that the earnings experience should follow business assets through sales and exchanges of all kinds. This would lead to duplicating claims to such experience on the part of both transferor and transferee corporations. No such problem can arise, however, where the properties acquired are substantially all the properties of the transferor, and the transferor is liquidated. Indeed, in these cases, if this experience may not be used by the transferee, it is completely lost as a measure of normal earnings.

SALE OF A LOSS DIVISION

The law should also permit taxpayers to exclude from their standard of normal earnings, as determined for purposes of the excess-profits-tax income credit, any over-all deficit during the base period in the operation of a trade or business which the taxpayer has wholly disposed of, thereafter using the proceeds of sale for different purposes.

The propriety of this proposal may be illustrated as follows: Suppose that during its base period the taxpayer was engaged in two distinct enterprises—the operation of a coal yard and an ice plant. The former was profitable and the latter unprofitable. In 1950 it decided to abandon the unprofitable ice business. It sold this business outright for cash, and using the proceeds of sale, opened a lumber yard. Under present law the taxpayer would be required to use a base-period earnings record which has no relation, logically or historically, to its new lumber business, and which is less than its actual base-period earnings from its coal business. The proposal would permit the net deficit on the ice-plant operations during the base period to be ignored, leaving the taxpayer with a standard of normal earnings for the coal business of its actual base-period earnings, and for the lumber business of zero.

The treatment which would be accorded by such a provision approximates that already accorded by present law in a situation in all respects identical except for the two businesses being held through two separate corporate entities. The only difference is that in the latter situation, the corporation acquiring the new lumber business could use any of the ice business' base-period profits years, while treating the loss years as zero. Under the proposal, the lumber business is, in effect limited to a zero standard for the entire base period.

The discrimination imposed by existing law against several businesses operated by a single corporation constitutes an unnecessary inducement to the formation of multiple corporations under the same ownership, which other provisions of the the bill are directed at discouraging.

The old excess-profits tax had a provision somewhat similar to the proposal, in that it allowed section 722 relief for a change in the character of the business. There, too, the remedy was more complete than in the proposal. Under proper circumstances, the taxpayer could not only discard the deficit record of the old business, but also adopt and use the reasonably expected standard of earnings of the new business.

There is no justification for shackling a taxpayer with a deficit earnings record on a business which it no longer operates. Even if it gets no affirmative relief, it should at least be able to go into a new business with a zero credit.

RELIEF PROVISIONS

The relief provisions of the present excess-profits-tax law are inadequate for two reasons: (1) they are faulty in their application to certain of the situations to which they are generally addressed, and (2) they are not addressed to certain general situations which clearly require relief.

Section 442 is intended to deal with interruptions of production, such as strikes and natural casualties. But let us look at cases where it fails to accomplish the purpose of affording the needed relief.

Suppose that the taxpayer had a bad year in 1946 owing to reconversion from war production, normally good years in 1947 and 1948, and in 1949 a strike tied up production and caused that year to result in a deficit. The year 1949, being the worst of the 4 years in the base period, must first be eliminated. Section 442 thereupon becomes unavailable and the taxpayer must use as the third of its base-period years the reconversion year 1946. If, on the other hand, the section 442 adjustment to 1949 could be made first, and after so determining normal income for 1949, the worst of the 4 years could then be eliminated, the taxpayer could have 3 years left of reasonably normal actual or constructiveincome from which to compute its base-period average.

Assume another case in which the effects of a strike were particularly severe and continued for more than one of the base-period years. In this case the taxpayer is required to use the industry rate of return for the entire base period, even though its own actual earnings during the years not affected by the strike were considerably higher than the industry average. If the law permitted these other 2 years to be averaged with a third year after a section 442 adjustment had been made to the third year alone, the taxpayer would enjoy a better base period average than relying on the industry rate of return alone.

A third example of the peculiar operation of section 442 is afforded by the situation in which the industry rate of return produces a base-period average only slightly higher than the taxpayer's actual average—say, 8 percent higher. Even though a strike or casualty may have severely affected taxpayer's earnings throughout 2 or 3 years of the base period, section 442 would not authorize relief because the reconstructed income would not exceed 110 percent of taxpayer's actual income.

More generally, it may be noted that use of the base-period rate of return, either under section 442 or any of the other relief provisions, does not afford relief to the efficient firm which, even though it qualifies, has an actual earnings record better than that produced by using an average which incorporates the record of less efficient firms and perhaps less speculative branches of the same industry.

Section 443 has at least two technical flaws. In the first place, when the alternative net income from new products test was added to the gross-income test, section 443 (a) (3) was not correspondingly amended to tie in the general growth requirement with the alternative net income requirement. In the second place, a taxpayer is apparently required to claim the benefits of section 443, if at all, in the first year in which it meets all of the required conditions, and consequently, in situations in which it thereafter continues to grow, may be held down to a lower constructive average base period net income than it might have had if it could elect the year in which it would first claim this benefit.

The basic shortcoming of all of the relief provisions is that they fail entirely to give any recognition to post-base period growth. This failure means that no encouragement is given to scientific research or development. The most pressing need is for an additional relief provision which will allow an addition to the credit otherwise computed for the current development of new products. This might perhaps be limited even to products not generally available to the public prior to the end of the base period. The amount of the additional credit could easily be determined by taking as a standard the ratio between the physical volume of sales of the product and the profit per physical unit on it during the first year it is sold, and applying this ratio to the volume of sales in subsequent years. Or, if it were desired to adhere to the general scheme of using an industry rate for all relief, the determination might be made by allowing the taxpayer to apply an industry rate to its assets employed in making the new product, providing that the industry rate used is that of the particular industry of which the new product itself is a part.

RECOVERIES WITH RESPECT TO WAR LOSSES

Under section 127 of the Code, originally enacted as part of the Revenue Act of 1942, taxpayers owning property in enemy countries were permitted to treat such property as having been seized or destroyed on the date war was declared, and thus to have an income-tax deduction computed in the same manner as for an involuntary conversion or casualty loss. This provision was prompted by the impossibility of ascertaining whether a seizure or destruction had actually occurred after the declaration of war, and also by the fact that rights in such properties were probably as completely severed by the outbreak of war itself as they would be by a later technical confiscation. As part of section 127, it was also provided that any recoveries of such properties would be treated as a realization of taxable income to the extent that the value of the recovered property exceeded all allowable war-loss deductions for prior years which had not resulted in a tax benefit.

This rule governing the tax treatment of recoveries with respect to war losses works considerable hardship. For example, suppose that a United States citizen owned two properties in Italy before the war which were then worth $10,000 each, but his cost basis in each property was only $6,000. Under section 127 the amount of his allowable losses in 1941 would have been limited to twice $6,000, or $12,000. Suppose that the war leaves one of those properties undamaged, and after the war the owner is restored to possession, but the other property is totally destroyed. If the deductions resulted in a tax benefit, the rule as to recoveries under section 127 would require him to include in his income in the year of recovery not only the $6,000 for which he was previously entitled to take a deduction with respect to the recovered property, but also an additional $4,000 because of another loss deduction on an entirely different property for which he will never recover anything.

This result represents a perversion of the tax-benefit rule which should be cured by limiting the amount of the recovery deemed to have been effected in any particular case to the lesser of the fair-market value on the date of recovery of the particular item recovered, or its adjusted basis.

Furthermore, an adjustment should be made so that the tax imposed on a recovery should be no greater than the tax benefit with respect to the corresponding loss.

Senator Hoey. Mr. Laylin, give your name and connection to the reporter.

STATEMENT OF CLARENCE D. LAYLIN, THE COUNCIL OF STATE CHAMBERS OF COMMERCE, AND THE OHIO CHAMBER OF COMMERCE

Mr. Laylin. My name is Clarence D. Laylin. I live in Columbus, Ohio. I am a lawyer and counsel for the Ohio Chamber of Commerce. I happen also to be chairman of the taxation division, or section, of the Federal finance committee of the Council of State Chambers of Commerce.

Senator Taft. I might say that Mr. Laylin was also counsel for the Joint Committee on Taxation on which I served, which rewrote the Ohio taxation laws in 1931.

Mr. Laylin. Unfortunately, that is getting to be a longer time ago every year.

Senator Taft. I am sure we all feel that way.

Mr. Laylin. This Council of State Chambers of Commerce, as the Senators probably know, consists of about 33 State and regional bodies. They are autonomous. Nobody makes up their mind for them. They do their own thinking. Therefore, there is some natural diversity of opinion among them. When anyone such as myself tries to speak for them, he has to take account of that natural diversity.

However, Senators, the first thing I say in my statement, which I am going to file, is that with respect to the merits and demerits of H. R. 4473, there is very little diversity of opinion. I think it is very bad, with the exception of some good measures like the long-awaited deferment of capital gain on the sale of taxpayer's residence, and some others of that character.

Our considered judgment—and here we are unanimous—is that this committee would do well to discard the House bill and start afresh.

In so doing, you will, of course, consider how much, if any, revenue in addition to what will be yielded by the present laws is needed to avoid deficit financing on a disastrous scale.

The revised estimates have just been discussed in my hearing, and I need not go into them further than to say that the apparent need for approximately $10 billion on the basis of these revised estimates does not convince us. We observe that the revised expenditure budget, for example, as submitted to you by the Assistant Director is, as I think Mr. Alvord said a moment ago, is just the same $71,600,000,000 estimated expenditure budget brought down to date. It still takes no account of what the Congress may do in reducing or eliminating spending programs, reducing appropriations, denying obligational authority that is requested, and so forth.

So until we are more thoroughly convinced, Mr. Chairman, than we are now that substantial additional revenue on top of the yield of present laws is needed, we would oppose any increased taxation at all.

In that same connection, we observe that the estimate of revenue yield of the existing laws is $58,500,000,000, and we think that you will conclude, as we have, that $61 billion would be a better figure there.

Now, we do not stop by saying that we are opposed to any increased taxation, because we apprehend that you may ultimately conclude that you do need more revenue. So we have some recommendations which are supported with substantial unanimity in the committee for which I am speaking, and have the general concurrence of the 33 State bodies to which I have referred.

The House bill recognizes that the only significant source of increased revenue is to be found in the three major categories—the corporation, the individual income tax, and the excises. Many State chambers, nearly all of them, would eliminate the corporation-tax increases, for this reason. Existing tax laws tax corporate income more severely than ever before, even during all-out war. These taxes have been increased twice, within the year, and in another way of speaking, I might say three times within the year, and the revenue effect of these increases has not yet been fully felt.

These corporation-income taxes, as I believe someone remarked a moment ago, are not direct taxes, either in contemplation of law or in economic effect. They are borne ultimately by human beings.

Now, in a free economy, their burden is or may be widely diffused. But when Government imposes economic controls and seeks at the same time to increase production, the stockholders, already doubly taxed in respect of their dividends, receive a heavier impact.

This impact is either direct, by immediate reduction of dividends, or indirect, by impairing the ability of the corporation to expand its facilities to meet the demand for increased production, thus driving it to the money lender and diluting the stockholder's interest.

We say in our statement that it would be inaccurate to say that the stockholder is a forgotten man under the House bill. He is too well remembered. His income is diminished at the source. As diminished, it is in part withheld at the source under this bill, and as it reaches him, it is doubly taxed, all this despite the fact, known to you gentlemen, that a large proportion of the stockholders of the country are in the fixed-income class, and despite the fact, too, that incentives to invest in the productive plants of our economy must be preserved and not stifled, if we are to carry forward the defense effort and at the same time fight inflation.

Furthermore, extremely high taxes on corporation incomes have in themselves an inflationary effect. I need not labor that point. I am sure you are familiar with it.

I suppose there is a limit somewhere, Mr. Chairman, beyond which corporation income taxes should not go even under actual war conditions. We do not say that the income taxes we now have exceed that limit. But we do believe that the present laws go as far as they should go under existing conditions, and that the House bill is beyond reason under any conditions.

So we oppose any increase in the normal or surtax rates of the corporation income tax.

We oppose raising the ceiling on the combined effective rates of corporation income and excess profits taxation. We strenuously oppose any lowering of the percentage of average base period net income excess profits tax credit, and we oppose limiting the members of the so-called controlled group to one $25,000 surtax exemption and one similar minimum excess profits tax credit.

In fact, we think no change should be made in the present structure and rates of the corporation income taxes unless it be to correct the numerous inequities in the excess profits tax law.

Now, before considering any increase in the individual income taxes, your committee, in the opinion of practically all of the State chambers, should look to an expansion of the field of excise taxation for any revenue that may be needed. The House bill, as we see it, fails lamentably at this point, and the Treasury's proposals are equally wide of the mark. Neither would appreciably broaden the base of excise taxation, but would merely increase the rates of a few of the time-honored excises and add a limited number of new taxes of a similar nature.

The Ohio Chamber of Commerce, for which I must speak in the first instance, believes that the selective excise system should be more widely extended, with continued emphasis upon those commodities and services which are in the nature of luxuries and those which utilize materials and labor critical to the defense effort, and that if additional revenue is needed to balance the 1952 spending budget, a sufficient amount could be obtained by this means with perhaps some recourse to moderately increased individual income taxes.

Some State chambers have recorded a strong preference for a uniform manufacturers' excise tax in substitution for the existing selective excises, and covering all commodities excepting liquor, tobacco, and food products.

The taxation subcommittee of the Council of State Chambers of Commerce recommends a uniform retail sales tax or consumers' defense tax at a moderate rate on all commodities, including those presently taxed at either the manufacturers' or at the retail level, but excluding food and food products.

For example, instead of raising the excise rates on liquor, tobacco, and gasoline, or on automobiles, let the defense tax apply on those commodities at the retail level, and let it apply as a surtax on sales of commodities now taxed at the retail level, and on admissions and some services, such as those of barber shops and beauty parlors.

Such a tax at 1 percent would, we believe, produce approximately $1 billion in new revenue.

I repeat that while there is this diversity of opinion as to means, practically all of the State chambers of commerce unite in the deep conviction that broad based excise taxation should be the first resort of your committee, should you find it necessary to raise more revenue in the fiscal year 1952.

I shall not take any time to present the arguments pro and con with respect to the means or the choice of means for accomplishing this broad objective. I assume that the committee is familiar with them. They have been widely discussed.

Let this committee accept the principle of excise taxation on a broad base and apply that principle with substantial uniformity so far as additional excises are concerned. That is perhaps more important than the precise method which you might employ.

In the statement, Mr. Chairman, which I shall file, I present some reasons why the State chambers believe in that general principle. The first is that consumption taxes are historically the oldest form of

Federal taxation, and their record has been one of stability throughout the years.

Secondly, in a balanced system, such taxes, adding the customs and the estate and miscellaneous receipts—in other words, all the taxes excepting the income taxes—should contribute at least a fourth of the revenue, and in 1950 they did produce $11 billion out of the gross total, before refunds, of approximately $39 billion. But as a result of what you have been doing, and I say the Congress has been doing, to the income taxes, individual and corporate, and the excess profits tax legislation, the revenue estimates now before you show a gross yield of approximately $12 billion from the excises and miscellaneous taxes combined, as against an estimated total before refunds of $61 billion.

If you were to keep the excises in line with the increases that you have already made in the individual and corporation income taxes, and desire to raise, let us say, picking a figure out of the air, $66 billion gross before refunds, which I suppose would be about $63,800,000,000 after refunds, you should have, to preserve that relationship, approximately $16,500,000,000 of gross yield from all the excises combined, as against $8 billion—no, more than that before refunds, I am sure—under the present system.

Senator MILLIKIN. Have you given study to the increased burden that would result from your suggestion on the lower income brackets?

Mr. LAYLIN. Yes, sir.

Senator MILLIKIN. Give me your ideas on that.

Mr. LAYLIN. We would not advocate imposing a tax at this time on food or rent, of course, rent not being a commodity——

Senator MILLIKIN. Would you impose it on medical?

Mr. LAYLIN. That would be probably for the Congress to decide. We have not said anything in our statement about that.

Senator MILLIKIN. Hospitalization?

Mr. LAYLIN. No. That would be a service, primarily.

Senator MILLIKIN. You say you would exempt rent?

Mr. LAYLIN. Oh, yes.

Senator MILLIKIN. You would exempt food?

Mr. LAYLIN. Yes.

Senator MILLIKIN. And you would let us decide whether to exempt medicine and hospitalization, and doctors' and dentists' fees?

Mr. LAYLIN. Of course; yes, sir.

Senator MILLIKIN. And when you got all through, we would have, your figure, a net of $1 billion for each point of increase?

Mr. LAYLIN. That is right.

Senator MILLIKIN. Now, on which category of income people would that $1 billion finally land with its main impact?

Mr. LAYLIN. With its main impact?

Senator MILLIKIN. Yes.

Mr. LAYLIN. I think it would land, of course, on all the people, on all the people as they spend.

Senator MILLIKIN. Yes. Seventy percent of the spending is in people that have incomes of less than $5,000?

Mr. LAYLIN. Surely.

Senator MILLIKIN. So the major part of the impact would fall on those people?

Mr. LAYLIN. Just as the major part of the impact, figured that way, even of income taxes, falls on those people.

Senator MILLIKIN. Now, that is exactly what I am coming to. So do you not have the problem of what would be the burden on those lower-income people, and to do that you have to figure on what they are paying now in open taxes, State, Federal, local, and what they are paying already in concealed taxes, and when you add that up you come to the question, Are you or are you not imposing too much burden on the lower-income people?

Mr. LAYLIN. Are you ready for me to comment, Senator?

Senator MILLIKIN. Yes.

Mr. LAYLIN. In the first place, we do not advocate a drastic tax. We would not impose a tax rate of more than 4 or 5 percent on the taxed transactions, in addition to what is now being imposed. We think that the imposition of a broad-based excise tax does not raise any serious problem of so-called regressivity, which I think you may have in mind, Senator, certainly not weighty enough to overbalance the already extreme progressivity of the individual income tax, and we think it is desirable to make everybody conscious of his responsibilities to support the Government in this time of need.

Senator MILLIKIN. I am merely tossing out a suggestion here. You might make everybody conscious of his inability to support the Government in this time of need.

I am not advocating this at all, but I am merely probing to try to get some perspective. A witness here not so long ago testified that a $2,500 income family is paying over $700 in taxes, $300 plus, in State direct taxes, State, local, and everything else, and about $400 of indirect taxes.

Now, let us call it $750, on a $2,500 income. That is a pretty good hunk of taxes for a citizen who has no margins?

Mr. LAYLIN. I would suggest that he, in common with all the rest of us, is paying even more in hidden taxes than he realizes because of inflation.

Senator MILLIKIN. Whether it is hidden or whether it is open, it is tax on him.

Mr. LAYLIN. It is a tax.

Senator MILLIKIN. And I am just trying to figure what would be the impact of taxes of the kind you suggest on that citizen, who is already paying a very high tax and who, as I say, is not operating on any fat, so far as income is concerned.

Mr. LAYLIN. That is right. He would be obliged to make new choices as he spent. I think that would be the full measure of the impact on him.

Senator MILLIKIN. That is an easy disposition of a very serious problem to the fellow that has to make those choices, because as I say, the limit of the amount of leeway that he has in figuring out his budget does not make that an inviting choice.

Mr. LAYLIN. I suspect that anything this committee may do by way of raising taxes will not present an inviting choice to any taxpayer.

Senator MILLIKIN. I quite agree with you. But we get into the subject there of relativity.

Mr. LAYLIN. I think we have a full appreciation for those considerations, Senator.

Senator MILLIKIN. To put it another way, I am not suggesting that what you are saying would put an excess burden on these lower income brackets, but if you put an excessively large, or unbearable burden on them, you are going to have strikes to redress their position.

Mr. LAYLIN. Right.

Senator MILLIKIN. And in the end, where do you come out?

Mr. LAYLIN. My thought with respect to the suggestion embodied in your last statement, Senator, is this: that all taxes have more or less that effect of inflation, by encouraging demands for higher gross income. That is the point you have in mind, I believe. But we think that this type of tax, the payment of which is at the option, so to speak, of the taxpayer to a certain extent—I do not want to overwork that proposition—is the least inflationary, in fact, of all forms of taxation that you could think of.

Senator HOEY. Is it not true, though, that a man with only an income of $2,500 has not much choice? He has to spend it all to support his family, so that he must pay these taxes without having much choice about it, because he cannot save much out of that. He cannot fail to spend much out of that. And if he is taxed on everything except food, for instance, he is paying it on everything that he buys for his family.

Mr. LAYLIN. All of his purchases; yes.

Senator HOEY. There is not much choice on his part. He has to pay it all.

Mr. LAYLIN. However, not upon his food nor upon his rent, nor upon his hospitalization or certain advices of his physician, and so forth. He pays nothing on that, under the idea that we have.

Senator TAFT. Of course, this is true as to the taxes. To a certain extent, it is not regressive because as you go down the income scale, a larger and larger percentage is spent for food. So it runs from 25 percent, we will say, in the upper brackets to 50 percent in the lowest income scale.

So, to a certain extent the burden of a 5 percent sales tax is lesser as you get down. I think that should be borne in mind.

The other point that I would make on the question is that after all, what we are spending this money for is to protect ourselves against the destruction of this country by atomic bombs and everything else, and the fellow with a low income is going to be wiped out just as fast as anybody else by such threat.

So it certainly is fair to ask him to pay some part of that defense of himself against attack.

Mr. LAYLIN. Yes, sir.

Senator TAFT. Now, as to how much and as to what his present burden is, those are all questions that we ought to study in trying to get this thing as fair as possible. That is about all that I could say at the present time.

Mr. LAYLIN. We have every confidence that you will, of course, Senators. We are presenting our view as to what we think is best. We do think that there is much there to both of the points suggested by Senator Taft. In the first place, we think that actually the greater amount of the revenue that will be derived from a tax of the kind that we have been discussing will come proportionately from the higher brackets rather than from the low income tax brackets, because of the high percentage that is spent for food and rent.

Senator TAFT. I am inclined to think the burden of taxation from local and State taxation on the lower-income groups is out of proportion, through the payment of real estate taxes, which are, in fact, sales taxes through the levy on downtown property, and the sales taxes themselves, in the local district.

Mr. LAYLIN. That is right.

Senator TAFT. I think if we made a complete study of that, we would find that that burden on the low-income people was pretty heavy. That is my impression.

Mr. LAYLIN. It could be. And yet, as you know, Senator, there has been very slight resistance to the 3 percent bracketed sales tax that we have in Ohio. People are quite accustomed to it, and accept it. I believe I can say that.

Senator TAFT. Now you are advocating the old theory that has been advanced of what is a good tax. I am reminded of the fellow who said, "The only principle in taxation is to get the most feathers with the least squawk."

That is another consideration. But whether they squawk or not, it may be unfair even though they do not squawk.

Mr. LAYLIN. You know, Senator—perhaps the other Senators do not know—that in our Ohio tax we expose that tax to the light of publicity by giving a little prepaid sales tax receipt. So everybody that pays that sales tax in Ohio, whether he is in the low income tax group or the high income tax group, is perfectly conscious that he is paying a tax. It is not hidden in any way. That is correct, is it not, Senator?

Senator TAFT. That is right.

Senator MILLIKIN. The burden is not less.

Mr. LAYLIN. The burden is not less.

Senator MILLIKIN. Whether it is a labeled tax or an indirect tax.

Mr. LAYLIN. That is right.

Senator MILLIKIN. The burden is not less. And I think the problem before the committee is to study the burden all the way along the line.

Mr. LAYLIN. We agree with you 100 percent.

I have not said anything about the individual income tax. We have some suggestions there. That is a direct tax, of course, except insofar as the withholding of wages may tend to pass the burden along. So even though the rates are pretty steep now, the progressive rates, there has been some mitigation of those rates recently, and to our way of thinking it would be less objectionable to increase the individual income tax properly than to raise corporate taxes. We do not like the method of the meat ax approach adopted by the House, the 12½ percent, and I think that that should be discarded. In fact, the very fact that the House found it necessary to adjust the top surtax brackets in order to prevent the proposed 12½ percent defense supertax from causing confiscation exposes, we think, the injustice and absurdity of that approach.

It magnifies unduly the practical effect of the progression that we do have. Of course, moderate progression is inherent, no doubt, in the time-honored conception of a tax on individual net income, but I think that we must agree that progression can be overdone, and we think it is, under the House bill.

We would accept the defense-tax principle that the House seems to have in mind if the additional tax could be levied in such a way as to mitigate the progression, or at least not unduly exaggerate it.

To the Ways and Means Committee of the House, we endorsed the plans proposed by the Committee on Economic Development as a method of obtaining additional revenue from individual income taxes, which would have that effect, and we commend that plan to your favorable consideration. But the addition of a given number of percentage points not exceeding three, we think, to each surtax bracket would have a somewhat similar effect and would be in line with the Treasury's original proposal. And we would accept that method. But we would suggest that if you adopted that method, the revised surtax schedule should be written as a defense tax in lieu, rather than as an amendment of the present statutory schedule. We do not favor lowering the individual exemptions and credits for dependents at this time.

There are a few features of the House bill which seem to us to be especially obnoxious, and we particularly recommend their objection here, and they are these:

First, the proposed defense-tax increase in the rate of taxation of net capital gains. What I have already said perhaps is a sufficient reason for that belief.

Second, we oppose the proposed withholding of taxes on dividends, interest, and royalties.

Now, from the point of view of the withholding agent, the provisions of the House bill may be superficially less objectionable than those relative to dividends which this committee struck out of the Revenue Act of 1950, though we believe them to be still subject to serious criticism. But from the point of view of the receipient, and particularly the very many low-income recipients of such payments who are not liable for income taxes, the proposal seems to us to be outrageous, in that at best it would amount to a continuing forced loan, and at the worst, to a sort of larceny by default, if you will permit a mixing of metaphors at that point.

I think the Senators understand what I mean when I say those things about the proposed withholding.

Now, we of the State chambers have long advocated the more effective taxation of various types of organizations which now enjoy tax advantages, yet compete with taxed business. The Ways and Means Committee of the House heard much testimony on this subject, but did nothing about it. We trust that this committee, with the record of that testimony before it, will rectify this glaring inequity.

Senator HOEY. Do you care to identify what the organizations are that you have in mind?

Mr. LAYLIN. The State chambers of commerce?

Senator HOEY. I am talking about those that ought to be taxed.

Mr. LAYLIN. We say in our statement that while we favor true cooperation by farmers, consumers, and other groups, we think that cooperatives are getting off too lightly under the present laws.

Senator HOEY. Is there anybody else that you think ought to be taxed?

Mr. LAYLIN. The House committee heard testimony relative to mutual savings banks and building and loan associations, and so forth. We would place them all in the same category. But I am not suggesting any specific remedy for that situation, Mr. Chairman.

Senator TAFT. I noticed that the larger sum involved seems to come from mutual savings banks and building and loans, compared to farmer cooperatives.

Mr. LAYLIN. Apparently so.

Senator TAFT. There seems to be three times as much there as in the farmer cooperatives.

Mr. LAYLIN. Yes; I suppose that is so.

Senator TAFT. I was wondering whether the Ohio chamber was advocating taxation of building and loans. Have they taken an official position on it?

Mr. LAYLIN. They have not taken an official position on it, Senator. I think we have only one mutual savings bank in Ohio, but we have plenty of building and loans.

I am instructed to say this, and I do so with considerable emphasis and seriousness. We are State organizations. We know what is going on in our State capitals and in the courthouses and on the main streets, and right now we see some real pressure building up for a constitutional limitation on the Government's power to tax the incomes and savings of the people. You know what I am talking about.

The State chambers, thus far, as organizations, have been chary of such a drastic safeguard against the excessive exploitation of these forms of taxation, but our committee senses a growing sentiment in its favor as a result of the passage of this House bill. We believe it our duty to call your attention to that and to suggest that that situation, which is a sort of incipient revolt against excessive rates of income taxes——

Senator HOEY. I think that that amendment has been ratified by 24 States.

Mr. LAYLIN. We hope that you will take account of that recommendation.

Thank you.

Senator HOEY. I have noticed in the paper that 24 States have passed resolutions to that effect.

Mr. LAYLIN. Twenty-four States. Some have sent in previous resolutions. But there seems to be considerable steam behind that right now.

Senator HOEY. Thank you, Mr. Laylin, for your statement. We are very glad to have had you.

(The prepared statement of Mr. Laylin is as follows:)

STATEMENT OF CLARENCE D. LAYLIN, ON BEHALF OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AND THE OHIO CHAMBER OF COMMERCE

MR. CHAIRMAN AND SENATORS: I am Clarence D. Laylin. I live in Columbus, Ohio. I am a lawyer, and counsel for the Ohio chamber of commerce. I am also chairman of the taxation section of the Federal finance committee of the council of State chambers of commerce. I appear in behalf of that committee, and, through it, in behalf of the 33 State and regional chambers of commerce and similar organizations which are represented in the council, including my own Ohio chamber.

These State chambers are autonomous bodies, principally interested in safeguarding and promoting the welfare of the business communities in their several States. The council and its committees constitute a clearing house for the interchange of opinions on matters of common concern. Federal expenditures and taxation are of that character.

On other occasions when I have had the honor to speak here for the State chambers, I have had to take account of some natural diversity of opinion among the 33 organizations. Today, in discussing H. R. 4473, I am not so constrained. Conceding to that measure a few minor virtues, such as the long-awaited deferment of capital gain from the sale of the taxpayer's residence, they feel that the bill as a whole is the worst of its kind in the history of the country. Saving only those fragmentary good provisions, this committee should, in the unanimous opinion of the State chambers, discard the monstrosity which has come from the House and start afresh.

In so doing, you will, of course, first consider how much, if any, revenue, in addition to what will be yielded by existing laws, is needed to avoid deficit financing on a dangerous scale. You have a revised estimate of revenue yield on the order of \$58.5 billion and a revised estimate of budget expenditures on the order of \$68.4 billion, indicating, on the surface, a need for approximately \$10 billion in additional revenue to balance the budget for fiscal 1952. These figures do not convince us. The full impact of the present tax laws, twice amended within the year, has yet to be felt; and we believe that the 1952 yield will probably approach \$61 billion, after refunds.

REDUCTION IN SPENDING ESSENTIAL

On the other side of the scale, we observe that the revised expenditure figures submitted by the assistant director of the Bureau of the Budget take no account of what the Congress may, and in our opinion must do by way of reducing appropriations, nor of several other factors which may well lessen the actual expenditures for 1952. Moreover, these figures assume that the Congress will in no case reduce, eliminate or postpone spending programs required by existing laws, and will grant new obligational authority as requested. We are convinced that the time has come when Federal public money must be saved by every means available to the Congress. All requests for new spending authority, not strictly military, should be refused. Existing military spending programs, and requests for additional obligational authority of that character, should be critically examined both as to amount and as to timing. We believe that substantial reductions in military appropriations for each of the next two fiscal years can be made by so doing. Foreign aid expenditures should be likewise scrutinized. Many public works and similar programs should be suspended or at least curtailed during the peak of defense spending.

These conditions have not yet been satisfied; but they could be, and we believe the Congress is in a mood to do so to the best of its ability. Until the outcome is more certain than it now seems to us to be, and the extent of the revenue needs can be more definitely appraised than can now be done, we would oppose any increased taxation.

On the assumption that your committee may ultimately find that it is necessary to raise some additional revenue, we have certain recommendations as to which there is substantial unanimity on the part of our committee and general concurrence on the part of the constitutent chambers of commerce.

FURTHER CORPORATION-TAX INCREASE UNWISE

The House bill recognizes that significant sources of increased revenue are to be found only in the three major categories of the corporation-income tax, the individual-income tax, and the excises. Most State chambers would eliminate the first of these. Existing laws tax corporate income more drastically than ever before, even during all-out war. Twice within the year have these taxes been increased, and the revenue effect of these increases has not yet been fully felt.

Corporation-income taxes are not direct taxes, either in contemplation of law or in economic fact. They are borne utlimately by human beings. In a free economy their burden is or may be diffused widely. When Government imposes economic controls and seeks also to expand production, the stockholders, already doubly taxed in respect of their dividends, receive a heavier impact. This impact is either direct by immediate reduction of dividends, or indirect by impairing the ability of the corporation to expand facilities, driving it to the money lender, and thus diluting the stockholder's interest.

It would be inaccurate to say that the stockholder is the forgotten man under the House bill. He is too well remembered. His income is diminished at the source; as diminished, it is in part withheld at the source; and as it reaches him, it is doubly taxed. All this despite the fact that a large proportion of the stockholders of the country are in the fixed-income class; despite the fact, too, that incentives to invest in the productive plant of our economy must be preserved, not stifled, if we are to carry forward the defense effort, and at the same time fight inflation.

Furthermore, extremely high taxes on corporation-incomes have in themselves an inflationary effect. I need not labor the point, as I am sure you are familiar with it.

There is a limit somewhere beyond which corporation-income taxes should not go, even under actual war conditions. We do not say that the income taxes we now have exceed that limit; but we do believe that the present laws go as far as they should under existing conditions, and that the House bill is beyond reason under any conditions.

So we oppose any increase in the normal or surtax rates of the corporation income tax.

We oppose raising the ceiling on the combined effective rates of corporation-income and excess-profits taxation.

We strenuously oppose any lowering of the percentage of average base period net income excess-profits-tax credit.

And we oppose limiting the members of a so-called "controlled group" to one $25,000 surtax exemption and one similar minimum excess-profits-tax credit.

In fact, we think no change should be made in the present structure and rates of the corporation-income taxes, unless it be to correct the numerous inequities in the excess-profits tax.

BROAD-BASED EXCISE TAXATION RECOMMENDED

Before considering any increase in the individual income taxes, your committee, in the opinion of practically all the State chambers, should look to an expansion of the field of excise taxation for any revenue which may be needed. The House bill fails lamentably at this point, and the Treasury's proposals are equally wide of the mark. Neither would appreciably broaden the base of excise taxation, but would merely increase the rates of a few of the time-honored excises, and add a limited number of new taxes of a similar nature.

The Ohio Chamber of Commerce believes that the selective system should be more widely extended, with continued emphasis upon those commodities and services which are in the nature of luxuries and those which utilize materials and labor critical to the defense effort; and that, if additional revenue is needed to balance the 1952 spending budget, a sufficient amount could be obtained by this means with perhaps some recourse to moderately increased individual income taxes.

Some State chambers have recorded a strong preference for a uniform manufacturer's excise tax, in substitution for the existing selective excises, and covering all commodities excepting liquor, tobacco, and food products.

The taxation subcommittee of the Council of State Chambers of Commerce recommends a uniform retail sales or consumers' defense tax at a moderate rate, on all commodities, including those presently taxed at either the manufacturer's or the retail level, but excluding food and food products. For example, instead of raising the excise rates on liquor, tobacco, and gasoline, or on automobiles, let the defense tax apply on these commodities at the retail level; and let it apply as a surtax on sales of commodities now taxed at the retail level, and on admissions and some services, such as those of barber shops and beauty parlors. Such a tax at 1 percent would, we believe, produce approximately $1 billion in new revenue.

This recommendation of our committee has been framed after long consideration of many alternatives. We are assured that it is supported by a substantial majority of the State chambers.

I repeat, however, that practically all of them unite in the deep conviction that broad-based excise taxation should be the first resort of your committee, should you find it necessary to raise more revenue in the fiscal year 1952.

I shall not take space to present the arguments, pro and con, with respect to the choice of means for accomplishing this broad objective. I assume that you are familiar with them, as the merits and demerits of each have been widely discussed. Let this committee accept the principle of excise taxation on a broad base, and apply that principle with substantial uniformity so far as additional excises are concerned. That is perhaps more important than the precise method which you might employ.

The case for the broad-based excise-tax principle as a dominant feature of a revenue measure at this time is this:

1. Consumption taxes are the oldest and most stable source of Federal revenues.
2. In a balanced system, such taxes, including customs and adding estate taxes and miscellaneous receipts, should contribute at least one-fourth of the revenue.

In 1950, such taxes produced approximately $11 billion out of a gross total of approximately $39 billion. But as a result of the 1950 income and excess-profits tax legislation, the system as it now exists shows an estimated gross yield of approximately $12 billion from excises and miscellaneous receipts against an estimated total of $61 billion. To keep the excises in line, and assuming that it is desired to raise, say $66 billion of gross revenue before refunds, or $63.8 net, the combined gross yield of this entire group should be at least $16.5 billion. The whole $4.5 billion of such an assumed increase could come from the excises, as I assume there will be no thought of increasing the customs or the estate taxes. And if $61 billion net is a more realistic estimate of the yield of the present revenue system than $61 billion gross, then, still assuming $63.8 billion net as the goal, the excises alone should be capable of yielding the approximately $3 billion required on that assumption.

3. Excise taxes are generally anti-inflationary. As a means of bridging the gap between spendable income and the supply of goods, they are the most effective of the available taxes.

4. Nearly half of the aggregate individual incomes is not taxed at all. Many individuals and associations of individuals pay no income taxes. It is sound policy to exact a felt contribution from every one who spends

Inasmuch as the principle which I am advocating would not involve the taxation of food or rent, and at most would impose upon the low-income recipient new choices in the making of occasional purchases, the so-called regressive aspect of the broad-based excise tax is not a serious problem, certainly not weighty enough to overbalance the already extreme progressivity of the individual income tax. Furthermore it seems desirable to make everybody conscious of his responsibility to support the Government in its time of need.

INDIVIDUAL INCOME TAX INCREASE TOO PROGRESSIVE

All of the State chambers believe that adequate development of excise taxes may make it unnecessary to resort to any increase in the individual income tax; and some of them are directly opposed to such an increase. The individual income tax is a direct tax, excepting insofar as the withholding of wages operates to pass the burden along. Hence, steep as the progressive rates now are, it would be less objectionable to increase the individual tax properly, than to raise corporate taxes. But if it be found necessary to raise additional revenue from this source, the "meat-ax" method adopted by the House should by all means be discarded. The very fact that the House found it necessary to adjust the top surtax brackets in order to prevent the proposed 12½ percent defense supertax from causing confiscation exposes the injustice and the absurdity of the proposal. This method magnifies unduly the practical effect of the progression in the surtax schedule. Moderate progression is doubtless inherent in the time-honored conception of a tax on individual net incomes, but progression can be overdone, and is, under the House bill.

ALTERNATIVES TO HOUSE PROPOSAL SUGGESTED

We would accept the defense tax principle, if the additional tax could be levied in such a way as to mitigate the progression, or at least not unduly exaggerate it. We endorsed to the Ways and Means Committee of the House the plan proposed by the Committee on Economic Development as a method of obtaining additional revenue from individual incomes which would have this effect and commend that plan to your favorable consideration. The addition of a given number of percentage points, not exceeding three, to each surtax bracket would have a somewhat similar effect and would be in line with the Treasury's original proposals. So we would accept this method, so limited, and suggest that the revised surtax schedule be written as a defense tax in lieu, rather than as an amendment, of the present statutory schedule. While considerable revenue would result from lowering the personal exemptions and credits for dependents, we are opposed to so doing under present conditions.

OTHER BAD FEATURES OF HOUSE BILL

While we have recommended that this committee discard the House bill as a whole, with some exceptions, certain other of its detailed features are especially obnoxious and we particularly recommend their rejection here. They are:

1. The proposed defense tax increase in the rate of taxation of net capital gains. Our reasons may be gleaned from my previous discussion.

2. The proposed withholding of taxes on dividends, interest and royalties. From the point of view of the withholding agent, the provisions of the House bill may be superficially less objectionable than those relative to dividends, which your committee struck out of the Revenue Act of 1950, though we believe these to be still subject to serious criticism. But from the point of view of the recipient, and particularly the very many low-income recipients of such payments who are not liable for income taxes, the proposal is outrageous in that it would at best amount to a continuing forced loan, and at worst to a sort of larceny by default.

Finally, the State chambers of commerce have long advocated the more effective taxation of various types of organizations which now enjoy tax advantages, yet compete with taxed business. The Ways and Means Committee of the House heard much testimony on this subject, but did nothing about it. We trust that this committee, with the record of that testimony before it, will rectify this glaring inequity.

We favor true cooperation by farmers, consumers, and other groups, but we vigorously oppose the enjoyment by such groups of special tax advantages for the purpose of avoiding the taxes that must be paid by competing private enterprises. If it is our purpose to drive private enterprises out of existence, no surer way can be found than by taxing them heavily while relieving their competitors from similar responsibilities. With taxes for all Government now taking a third of the people's income, it is more vital than even hat we provide the broadest possible tax base to support such a burden.

In conclusion may I say this:

The organizations I represent are State organizations. We know what is going on in our State capitols, in our country courthouses, and on our main streets. Right now we are seeing some real pressure building up for a constitutional limitation on the Government's power to tax the incomes and the savings of the people. State chambers of commerce have thus far been chary of such a drastic safeguard against the excessive exploitation of these forms of taxation. But our committee senses a growing sentiment in its favor as a result of the passage of the House bill; and we believe that this situation merits your earnest consideration as you proceed with your deliberations.

Senator Hoey. This concludes the morning hearings, and the committee will take a recess until 10 o'clock tomorrow morning.

(Whereupon, at 11:45 a. m., the committee recessed to reconvene at 10 a. m., Tuesday, July 24, 1951.)

REVENUE ACT OF 1951

TUESDAY, JULY 24, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry F. Byrd presiding.,

Present: Senators Byrd, Johnson of Colorado, Millikin, Taft, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. The meeting will come to order.

I understand that Mr. Bernard N. Burnstine, merely desires to insert his statement in the record.

STATEMENT OF B. N. BURNSTINE, DIRECTOR, NATIONAL ASSOCIATION OF CREDIT JEWELERS

Mr. BURNSTINE. That is correct, Senator.

Senator BYRD. Mr. Burnstine, if you will identify yourself for the reporter, please, you may then proceed.

Mr. BURNSTINE. I am B. N. Burnstine. I would like to have my statement placed in the record.

Senator BYRD. Thank you very much.

(The prepared statement follows:)

STATEMENT OF B. N. BURNSTINE, DIRECTOR OF THE NATIONAL ASSOCIATION OF CREDIT JEWELERS, NEW YORK, N. Y.

Section 123, which proposes that the surtax exemptions and minimum excess-profits-tax credit of related corporations be limited and restricted in their applications, where certain common ownership of voting stock exists, is an inequitable application of the taxing authority. It will impose an uneconomic burden, and will prevent creation and expansion, particularly in small business.

IMPACT ON GROWTH OF SMALL BUSINESS

The growth of our economy has been achieved through the ingenuity and ability of enterprising individuals to commence businesses with relatively modest amounts of capital and by retention of earnings increase their capital funds, thereby providing additional employment for producers, manufacturers and retailing.

The enactment of this section will retard, if not stifle, the growth of small business. Presently it is most difficult for young and growing businesses to retain earnings to build a capital structure sufficient to meet adverse conditions. This section will make it almost impossible. Plans for formation of new small business enterprises are being suspended awaiting the passage of this revenue bill. If section 123 remains a part of this bill, most of these plans will be abandoned.

UNWARRANTED TAX ADVANTAGE DOES NOT EXIST

Though this section is intended to prevent some businesses from taking so-called unwarranted tax advantage by a series of corporations, rather than a single corporation in fact, no such unwarranted advantage is present. All corporate businesses may avail themselves of the privilege of operating through multiple corporations if there is a sound business purpose to so operate. The revenues are protected since the Treasury may prevent truly unwarranted tax advantage through corporate split-ups.

Multiple corporations that have not split up, despite their ability to do so under present law, have refrained because of disadvantages they seek to avoid. To place an increased burden on those stockholders that find it advisable and necessary to operate through several corporations is to penalize them unfairly.

INEQUITIES THAT WILL ARISE UNDER SECTION 123

An individual or a group of not more than five, who have similar stockholdings in more than one corporation, are conducting principally more than one individual small business or essentially unrelated businesses. Should such an individual or group, who conduct two retail stores, each in a different city (or even under different trade names) through separate corporations; or who, through one corporation, operate a grain and feed business and through another own real estate, be subjected to competitive disadvantage and an unfair tax burden?

The effect is to tax small business at rates intended for big business solely because the ownership of the voting stock classifies the corporations as related under the proposed section.

EXCESSIVE TAX INCREASE IMPOSED BY SECTION 123

The revenue sought to be raised will weigh unevenly upon existing businesses. In the following illustration, two small corporations whose stockholders cause them to be classified as "related" corporations, will pay 64 percent more income taxes than under present law, whereas the pending bill is intended to increase the rate of small corporations (earnings under $25,000) 5 percentage points or 20 percent:

Income taxes

	Net income	Present law	Proposed, including sec. 123
Corporation A	$25,000	$6,250	$10,250
Corporation B	25,000	6,250	10,250
Total	....	12,500	20,500

This increase is exclusive of and in addition to the burden of the proposed limitation on the minimum excess-profits-tax credit. The limitation on the minimum excess profits tax credit may add as much as $7,500 in excess-profits taxes to the above two taxpayers. In that event, their total income and excess-profits-tax liability would rise from $12,500 under the present law to $28,000, or an increase of 122 percent.

RELIEF FOR INSTALLMENT BASIS TAXPAYER

The National Retail Furniture Association has appeared before your committee and filed a statement on provisions needed to provide an equitable imposition of tax on installment basis taxpayers during a period of emergency.

Our membership is in full and complete accord with the position set forth in that statement, and recommends that your committee give favorable consideration to the suggested legislation contained therein to relieve installment basis taxpayers from what would constitute otherwise a harsh and inequitable impact of emergency income-tax rates.

Senator BYRD. Our next witness will be Mr. J. Carter Fort. Have a seat, sir, and identify yourself to the reporter.

Mr. Fort, I would like to say at the beginning of the hearing this morning that we have a large number of witnesses and we are trying to hear them all, and we would like, if possible, for you to confine your statement, I think, it is, to 10 minutes, is it not?

STATEMENT OF J. CARTER FORT, VICE PRESIDENT AND GENERAL COUNSEL, ASSOCIATION OF AMERICAN RAILROADS

Mr. FORT. Mr. Chairman, I will have part of my statement copied into the record to save time.

Senator BYRD. I say you are provided 10 minutes; is that right?

Mr. FORT. Thirty minutes.

Senator BYRD. What?

Mr. FORT. A half hour, so I was told, but I will hurry through.

Senator BYRD. Please hurry through it.

Mr. FORT. Mr. Chairman, and members of the committee, my name is Carter Fort.

I am a lawyer with offices and residence in Washington, D. C.

I appear here for the Association of American Railroads, of which I am vice president and general counsel.

That association is a voluntary nonprofit organization, including in its membership almost all the class I railroads of the United States—that is to say, railroads with operating revenues of more than a million dollars a year.

Its membership comprises railroads operating approximately 95 percent of the railroad mileage of the country, and having operating incomes approximately 95 percent of the gross revenues of all the rail carriers of the country.

I shall confine myself to a discussion of a limited number of the features of the pending tax legislation which are of special concern to the railroad.

The first subject I shall discuss is the matter of the corporate tax rate.

It goes without saying that rail transportation is a primary essential to both the civilian economy and the national defense. In the present emergency period the railroads are called upon to undertake a heavy program of capital expansion, through acquisition, at current high costs, of a large number of new freight cars and much additional motive power and the enlargement of their fixed properties to meet the exigencies of the present and the prospective emergency.

There are only two sources of funds for these expenditures, namely, investment capital and earnings; and in the case of the railroads, the availability of investment capital under existing conditions is, in large measure, limited to borrowings for expenditures for unencumbered new equipment, because fixed property is already mortgaged, and the level of railroad earnings is not such as to attract equity capital.

At the now existing burdensome level of corporate tax rates, the availability of earnings as a source of funds is severely, even critically, restricted by the circumstance that it takes $1.90 of earnings to produce $1 for capital expenditures, after 47 percent is deducted for Federal income taxes.

Senator TAFT. Say that again.

Mr. FORT. $1.90 of earning is required to produce——

Senator TAFT. Earnings?

Mr. FORT. In order to have a dollar left to buy new equipment, or to expand in any way.

That, Senator Taft, is not all. In replacement of equipment our new costs are so much greater than the cost of the equipment which is being replaced that our depreciation reserves fall far short of being sufficient to replace the property.

In the circumstances, it will hardly be a cause for surprise that the railroads view with great concern the provision of the House bill, H. R. 4473, which would exact in the form of Federal income taxes, more than one-half of each dollar of net income, and would indeed carry the rate to the unprecedented level of 52 percent.

Just how the railroads could carry such a tax burden and at the same time meet the imperative requirements of the present emergency, it is difficult to comprehend.

The railroads, therefore, have associated themselves with those who have appeared before your committee in opposition to any further increase in corporate tax rates.

In the case of the railroads, the menace of an unsupportable burden of Federal income taxes is even more serious than in the case of general industry. To some extent, at least, industries in general are in a position to ride with the business cycle through curtailment of operation and adjustment of price, as circumstances indicate.

Railroads do not have the same freedom to discontinue or curtail operations even though they may be unprofitable. Nor can they adjust their charges to variations in their cost without prior authorization of sundry regulatory agencies, with the inevitable procedural delays involved in the process.

The regulatory system under which the railroads operate not only requires that the price of their services be fixed but also affects nearly all of their other activities.

Under that system the railroads, during the 30-year period from 1921 to 1950, have had to function at an average rate of return on depreciated investment of approximately 3.64 percent.

In the decade of the forties, which included the peak World War II traffic years, the rate of return averaged 4.11 percent.

During the five postwar years, 1946–50, when business activity was great, the traffic was heavy and corporate earnings in general were at a high level, the rate of return for the railroads averaged only 3.51 percent.

With this history in mind, it is small cause for wonder that equity capital is largely unavailable to the railroad industry and that earnings must be looked to as a principal source of funds for railroad upkeep and expansion.

In view of the imperative current needs for adequate maintenance and substantial expansion of the railroad plant, we respectfully suggest that nothing short of the most dire necessity could justify an increase in the rate of the Federal income tax imposed upon the railroads.

The present rates are all but insupportable.

And in our considered judgment there is no justification for entertaining a proposal to take away in Federal income taxes more than one-half of corporate net income as is proposed in H. R. 4473.

Senator TAFT. With the provisions which we put into the law last year, are any railroads subject to excess-profits tax?

Mr. FORT. Yes; Senator Taft, some railroads are.

Senator TAFT. Not too many?

Mr. FORT. Not a great many, sir.

Senator MILLIKIN. Well, those that are do not have the difficulties that you are referring to; do they?

Mr. FORT. I am sorry, Senator Millikin, I did not hear you.

Senator MILLIKIN. Those that are subject to the excess-profits tax do not have the difficulties to which you are referring.

Mr. FORT. There is a wide range in railroad earnings, in the earnings between the different railroads, and necessarily so. There is a uniformity about the rate level, and necessarily, by reason of the competitive situation. The fact is, therefore, and I think it will always be the fact, that there is a very wide range in railroad earnings. The earnings of some railroads, some few railroads, are quite satisfactory. The earnings of most are quite unsatisfactory. The average earnings of the industry as a whole are unsatisfactory and inadequate.

Senator TAFT. But so far as maintenance and improvement, what is the rule for the maintenance and improvement of roadbed? Is that all expenses? You do not get depreciation, and you do get all expenses?

Mr. FORT. There is no depreciation as to many roadway items. Generally speaking, rails, ties, and track items are not depreciated but bridges, buildings, and like structures are. There is depreciation as to equipment.

Senator TAFT. I was talking about roadway.

Mr. FORT. As to some items there is depreciation, but as to many there is not.

Senator MILLIKIN. As to rails, for example, is that depreciated?

Mr. FORT. No, they are not depreciated.

Senator MILLIKIN. Maintenance of the roadbed?

Mr. FORT. That is an operating expense.

Senator TAFT. I just wondered whether, in view of the peculiar situation of the railroads, some similar treatment of equipment might not be justified, that is, just like the man replacing his old house with a new house—with the possible expensing of actual replacement, where the equipment was no larger——

Mr. FORT. When rail is replaced which is heavier than the rail that it replaces, the additional weight goes in as a capital item.

Senator TAFT. Yes, sir. That would be true of equipment, but not the increase in price due to inflated prices.

Mr. FORT. When ballast is made heavier and thicker than it was before, the additional thickness of the ballast goes in as a capital item, so it is necessary for the railroads constantly as a part of what most people would regard as maintenance, to make large additional capital investments in roadway. The roadway of course, is already mortgaged.

There is no way to get that additional capital except from earnings.

So, to a large extent, very large extent, the railroad is required—and there is no other possibility—to use earnings for capital expenditures.

Returning to my prepared statement: For reasons I have given, we oppose the increase in over-all ceilings upon Federal taxes from 62 to 70 percent, as provided in the House bill.

Highly objectionable also, in our view, is the retroactive feature of the House bill whereby the increased rates would apply beginning

January 1 of this year, although it seems certain that the tax bill will not be enacted before September or later.

In the case of individuals the House bill avoids retroactivity, at least in large part, by deferring them until September—deferring until September the proposed increase in rates.

It is certainly no less important that retroactivity be avoided in the case of corporations. As to the railroads, their books are kept on an accrual basis; their budgets are on the basis of current tax rates, allocating to capital improvements, revenues not needed to meet operating expenses, taxes, interest and relatively minor distributions to stockholders by way of dividends.

A retroactive increase in taxes can hardly fail to bring about a serious curtailment in capital improvements already planned and even already actually in progress. Obviously, such a result would not be in the interest of national defense.

During the past 5 years we have expended roughly about $1½ billion in improvements to roadway, and about $3½ billion in equipment, so it is an enormous sum of money that must be constantly available for capital expenditures.

Senator BYRD. What is the average rate of depreciation in the equipment and roadbed, what percentage?

Mr. FORT. What percent depreciation? It varies.

On freight cars, I think the depreciation is on the basis of a 33-year life. Even, however, if the rate of depreciation were entirely correct and accurate, it would not solve our problem, because we are depreciating a car that cost $2,700, and if you assume we have the entire amount depreciated and the $2,700 in the bank, when the car is replaced it costs over $5,000.

Senator MILLIKIN. That is the problem of all industry.

Mr. FORT. Yes, sir.

Senator MILLIKIN. That is a problem of all industry.

Mr. FORT. That is true. But all industry is not regulated and not held down in its earnings to the same extent.

Senator MILLIKIN. I understand.

Senator BYRD. What about the roadbed, what is the depreciation?

Mr. FORT. Well, some items are depreciated as I have said. Many of the items of roadway are not depreciated at all, but on a retirement basis.

Senator BYRD. What is the percentage rate where you do depreciate?

Mr. FORT. I do not know, but I will know before I leave.

Senator BYRD. You say rails are not depreciated——

Mr. FORT. No.

Senator BYRD. Unless you replace them with a heavier rail, is that correct?

Mr. FORT. That is true. Rails as I understand it, Senator, are on a retirement basis.

Senator TAFT. You replace a rail, and if it is replaced with a rail of the same size, you charge it to expense.

Mr. FORT. That is right, operating expense, but a heavier rail goes in as capital expenditure.

I now have the depreciation figures on road structures.

On road property the average depreciation is about 2 percent. It is the inflationary cycle, of course, that has caused the deep trouble in respect to depreciation, and which has made our depreciation reserves wholly inadequate to serve the purpose that they were intended to serve, and that we had every right to think they would serve.

There is another feature of retroactive tax increases in their application to railroads which should not be overlooked. The charges received by the railroads for their services are fixed by governmental authority, and this, of course, is generally true of the charges of all public utilities.

The level of such charges is not fixed, and could not be fixed, with any reference to a possible retroactive increase in taxes which might be accomplished by a law to be enacted in the future, at some future date.

Neither could increases in railroad charges granted subsequent to the enactment of the new tax law be made retroactive to correspond to the retroactive tax increase.

Thus, a grossly inequitable situation would arise which would not only work irreparable injury to the railroads, but also would operate adversely to the public interest in an adequate and efficient national transportation system.

If a policy is to be adopted of making tax increases retroactive, it will render difficult, if not virtually impossible, any orderly and constructive regulation of railroad rates and the rates of other utilities by the governmental agencies which have been set up for that purpose.

I come now to the single surtax tax exemption provisions of the House bill.

As we understand it, a principal purpose of the provision in section 123 of the House bill, restricting a group of affiliated corporations to a single surtax exemption and a single minimum excess-profits credit, is to prevent tax avoidance through the artificial division of a single enterprise into a number of so-called split-off or spin-off corporations created to obtain the benefit of the separate surtax exemption and a separate excess profits tax credit for each.

The report of the Ways and Means Committee of the House indicates that the split-off device came into considerable use during World War II, and may be expected to become more prevalent under the incentive of current high corporate tax rates.

We do not quarrel with the purpose to curtail tax avoidance through artificial division of the single enterprise into a chain of separate corporate entities, but the provision of the House bill reaches far beyond such a purpose.

It would reach many corporate set-ups of long-standing, created as the result of legal requirements or by reason of wholly legitimate business considerations, quite apart from tax avoidance.

In the case of the railroads, virtually all of these corporate relationships are of long standing, and antedate any possible motive to split off corporations for tax avoidance purposes.

Public convenience and necessity require that railroads operate across State lines, but the provisions of law in some States have necessitated, as a practical matter, the existence of subsidiary corporations.

For example, where a State has prohibited railroad property from being owned by a foreign corporation or has refused to grant the power of eminent domain to foreign corporations, it is apparent that a separate corporation had to be continued or created under the laws of that State.

The result has been that the major railroad systems of this country have developed, not only by mergers, but also by a process of leasing railroad property, which form an integral part of the operating system of the lessee.

In the railroad field, therefore, multiple corporate set-ups are the rule rather than the exception, and this is in no sense the result of artificial splitting off, with an eye to the tax laws.

We strongly urge, therefore, that if the single exemption feature of the House bill is to be retained, it be modified to apply only to corporations created subsequent to a certain specified date, say, October 8, 1940, the date of the enactment of the Second Revenue Act of 1940, when the World War II excess-profits tax was first imposed.

Prior to that date, there could have been no motive for corporate split-offs for the purpose of obtaining additional exemptions or credits.

We would also suggest further amendment to make the single exemption provision inapplicable to corporations created after the date selected in those instances where it is shown to the satisfaction of the Commissioner that the corporation was created for legitimate business purposes, other than tax avoidance.

Thus amended, section 123 of the House bill would be confined in its scope to the effectuation of a purpose to discourage split-offs for tax avoidance and the section would not be applicable where no element of tax avoidance is involved.

Coming now, Mr. Chairman, to the feature of withholding on dividends and interest, the railroads are in complete agreement with the premise that taxes should be paid on all taxable income, and that all reasonable means should be used to prevent an escape from the payment of taxes, either by individuals or corporations, and whether as a result of underreporting of dividends and interest or otherwise.

However, they question the advisability of further transferring the tax-collecting function from the Treasury to corporations. There is no question, it seems to me, that serious hardship will result in many instances from the want of relationship between the amount withheld and the amount of taxes due, if any. Many taxpayers will be put to the necessity of procuring refunds and will be deprived of the use of their money, at least for a season.

In important instances, indeed, overwithholding would be inevitable.

A case in point is the payment of dividends to corporations. These dividends are taxable to the extent of 15 percent of their amount.

Assuming a combined normal and surtax rate as high even as the 52 percent proposed in the bill, the tax would not exceed 7.8 percent—yet 20 percent would be withheld.

In many instances this result and the attendant delay in obtaining a refund would seriously impair the working capital of the recipient corporation.

This situation would seriously affect many railroads.

Senator BYRD. Where do you get the figure that the tax would not exceed 7.8 percent?

Mr. FORT. Well, the tax would be, under the law as I understand it, on 15 percent of the dividends received by the corporation, and at the rate of 52 percent in the House bill would be 52 percent of 15 percent, which makes 7.8.

Senator BYRD. You have assumed that the taxpayer has no other income, I assume?

Mr. FORT. No; this——

Senator TAFT. This is intercorporate.

Mr. FORT. Intercorporate; yes.

There are a number of railroads which receive dividends in quite large amounts from the stock of other railroads which they own.

To ameliorate this particular hardship, it would seem that if withholding on dividends is to be required, the corporate recipient of dividends should be permitted to set off the amount withheld against any amount due from such corporation as income, or payroll taxes, along the lines of the provision already in the House bill with respect to tax-exempt corporations.

The House bill would exempt from withholding, among other things, interest on equipment trust certificates, and we think that is a very wise provision.

The report of the Ways and Means Committee of the House indicates that the reason for the exemption of equipment trust certificates from the requirement of withholding is that they are ordinarily held by corporations.

Conditional sales agreements are widely used by railroads in financing the acquisition of new equipment. They serve in that connection the same purpose as equipment trust agreements. Like equipment trust certificates they are ordinarily held by corporations.

Unpaid balances on such agreements entered into by the railroads aggregated slightly in excess of $392 million as of December 31, 1950.

We urge that if a withholding requirement is to be retained in the bill, the exemption with respect to interest on equipment trust certificates should be enlarged to include interest payable under conditional sales agreements.

But we think that in any event the requirement of tax withholding on dividends and interest, as provided in the House bill, should be deferred until the effect of the new reporting requirements can be known.

This year, for the first time, under the regulations of the Commissioner, corporations are required to report all payments of dividends regardless of amount, and the recipient taxpayer is required to itemize all dividends received.

No opportunity has yet been afforded to judge the efficacy of these measures in minimizing the evil at which the proposed withholding is directed. Until that is known, we think your committee is not in a position to gage the extent of the evil, and to measure the benefits of the proposal against the hardships involved in it.

I come now, Mr. Chairman, to the matter of the penalty for filing consolidated returns.

The railroads have frequently urged your committee, and have urged the Ways and Means Committee of the House, to repeal the 2-percent penalty for filing consolidated returns.

In practical effect, the impact of this penalty is, of course, increased sharply as the corporate tax rates rise.

We think the penalty without justification in any event, but when consideration is being given to a bill which would place the combined corporate normal and surtax at 52 percent, it is especially important, we think, that your attention be directed to the fact that the combined rate under such a measure would reach 54 percent in the case of consolidated returns, and leave a bare 46 percent of net earnings available for corporate purposes.

The exigencies of the present situation impel us again to urge the repeal of this penalty.

It may be taken for granted, we suppose, that under existing emergency conditions and the consequent revenue needs of the Government, the combined corporate normal and surtax rate will be fixed at the maximum figure deemed consonant with the preservation of a sound and vigorous economy.

If this is so, it follows that the exaction of a penalty of two additional percentage points in the rate would, in many cases, carry the rate to a level higher than the maximum regarded by Congress as justifiable. And yet consolidated returns are consonant with the principle of levying taxes according to the true net income of a single enterprise, and they have, as we understand it, been favorably regarded by the Treasury from an administrative standpoint.

The imposition of a penalty for filing consolidated returns is particularly inappropriate in the case of railroads. Most of the railroad systems, as I have already pointed out, have of necessity been built up through a combination of a number of comparatively small railroads.

By reason of sundry controlling factors, including in many instances the requirement of State law, it has often been impossible to effectuate integration through consolidation or merger.

The continuance of subsidiary corporate entities has frequently been a practical and a legal necessity, and the acquired properties in such cases have been integrated into the operating system through long-term leases or by other means.

Multiple corporate entities within a single railroad system have thus resulted as an incident of the process of evolving a limited number of railroad systems capable of rendering a national transportation service in accordance with the requirement of the national economy and the dictates of the national transportation policy.

At times in the past Congress has recognized the special situation of the railroads with reference to consolidated returns.

Thus, when consolidated returns were abolished insofar as other businesses were concerned, by the Revenue Act of 1934, railroads, because of their special situation, were still permitted to file them.

In 1934—from 1934 to 1939, railroad companies alone were permitted to file consolidated returns, and in 1940 and 1941 railroads alone were permitted to file consolidated returns with respect to normal taxes and surtaxes, other corporations being confined to consolidated returns for the purpose of excess-profit taxes alone.

During the latter years mentioned no penalty was exacted. We think that on principle the penalty should be removed as to all corporations, but, in any event, we submit that the particular situation of the railroad industry should be recognized under present conditions, and the penalty eliminated as to that industry.

I come now, Mr. Chairman, to a point which I will touch very lightly, and ask leave to have copied in the record an additional statement.

Senator Byrd. Yes.

Mr. FORT. We understand that your committee may conclude to defer until next year any revision of the excess-profits-tax law of 1950, but that suggestions for revision are acceptable now for consideration at such time as that act may come under review.

The railroads do not urge that the Excess Profits Tax Act be reconsidered at this time. They are in accord with the thought that the matter would be better deferred until there has been more adequate experience under the act as it now stands.

Senator MILLIKIN. We thought that the railroads were fairly well satisfied with what we did.

Mr. FORT. That is entirely correct, Senator. The point——

Senator MILLIKIN. We went to extraordinary pains to take care of the situation and—that is the railroad situation and the public utility situations.

Mr. FORT. The point I have in mind to be considered for amendment in the future is a technical point, having nothing to do with the philosophy of the law as it is written. I will make that clear in just a minute. We are concerned that at an appropriate time consideration be given to a clarifying amendment having to do with the status of the long-term lessor and lessee railroad companies with respect to the availability of consolidated returns.

The apprehension is that, under the technical provisions of the Excess Profits Tax Act, consolidated returns may be available to those corporations only in the event that the lessee, that is, the operating company, foregoes the public utility excess-profits credit provided for by section 448 of the act.

It is not believed that any such result was anticipated or intended. A simple clarifying amendment would prevent it. I do not wish to go at length into the matter here and now, but I ask that there be incorporated at this point in the record a brief statement with respect to it, as a part of my testimony.

May I have that permission, Mr. Chairman?

Senator BYRD. It will be incorporated, sir.

(The matter referred to is as follows:)

Section 448 of the Internal Revenue Code provides an alternative excess profits credit for regulated public utilities. This credit, in the case of railroads, is measured by a return of 6 percent upon net assets, after allowance for normal tax and surtax liabilities. To be entitled to this alternative credit a railroad corporation must be engaged as a common carrier in the furnishing or sale of transportation by railroad, subject to the jurisdiction of the Interstate Commerce Commission, and at least 80 percent of its gross income (computed without regard to dividends and capital gains and losses) must be derived from the furnishing or sale of transportation by railroad (sec. 448 (c) (3); 448 (d)).

Section 141 of the Internal Revenue Code, as amended by the Excess Profits Tax Act of 1950, provides for the filing of consolidated returns by affiliated corporations which are regulated public utilities within the meaning of section 448.

We believe that the law should be clarified to make certain that a lessor railroad corporation which leases substantially all of its property to an operating lessee railroad corporation which utilizes the public utility credit may be joined with such lessee in the filing of a consolidated return. Although the lessor company is subject to the jurisdiction of the Interstate Commerce Commission, and its properties are operated by the lessee as integral parts of its system in the furnishing or sale of transportation by railroad, and its revenues, in the form of rental, derive from such operation, nevertheless the lessor does not itself operate the property and it does not derive its revenues directly from the furnishing or sale of transportation. It should be made clear that section 141 of the code does not preclude the lessee from joining the lessor in a consolidated return, except at the sacrifice of the alternative credit to which the lessee is entitled under section 448.

It is believed that Congress did not intend that the consolidated return provisions applicable in the case of these lessor-lessee railroad relationships should operate as a barrier to the availability to the lessee of the special public utility credit, or that utilization of that credit by the lessee should preclude a consolidated return.

As has already been stated, most of the major railroad systems today are the result of the combination of a number of comparatively small railroads. In many cases, substantial obstacles have prevented the merger and consolidation of these smaller companies into one large corporation. Among these obstacles are State laws; franchise rights; rights of minority stockholders; and mortgage, lease, and contract provisions. As a result of these and other considerations, the major railroad systems of the country have developed, not only by mergers and consolidations, but in substantial part through long-term lease arrangements.

Under an arrangement of the latter type, the company which owns the properties leases them for a long period of years to an operating company. Thereafter, the lessor ceases operations, although it continues its corporate existence, receiving rental for the use of its properties ordinarily measured by the requirements of interest on the indebtedness of the lessor and dividends on its capital stock.

The lessee takes over the complete management and control of the properties of the lessor and incorporates them into its railroad system. The facilities of the lessor and lessee become integrated parts of a single unified system. It is then not possible to determine for any given period of operation the amount of income attributable to the operations of the leased properties and the amount attributable to the operations of the properties owned by the lessee. Revenues and expenses have become amalgamated. The properties of the respective corporations are regarded as a unit by the Interstate Commerce Commission for rate making and other regulatory purposes and the value of the properties of the lessor is included in the rate base of the lessee, the operating company.

There is thus presented the typical case for a consolidated return and there is certainly no reason why it should be available only at the cost to the lessee of the alternative public-utility credit.

It is accordingly urged that section 448 (d) be amended by adding at the end thereof a clarifying provision that, for the purposes of section 448 and of section 141, a railroad corporation which has leased substantially all of its property to a common carrier shall be deemed to be a common carrier engaged in the furnishing or sale of transportation and that the rents receivable under such a lease shall be considered to be derived from the furnishing or sale of transportation.

Under such an amendment any possible impediment to consolidated returns would be removed where at least 80 percent of the lessor's income was derived from rentals under the lease.

The untoward—and, it is believed, unintended—deprivation in the typical railroad lessor-lessee relationship of the right to file a consolidated return and utilize the regulated public-utility credit would be obviated.

The suggested amendment is submitted with confidence that it accords with the policy embodied in section 448 and eliminates a possible obstacle to the filing of consolidated returns which ought not to be interposed in the case of railroad leases of the character described.

Mr. FORT. May I ask those of you who are following what I say in the written statement to turn to the bottom of page 13. There begins a discussion of the treatment of back mail pay.

There is one additional matter which I am constrained to call to the attention of your committee because the railroads may become compelled at a somewhat later date to request an amendment of the tax bill with respect to it. The situation to which I refer is this:

In February 1947 the railroads filed an application with the Interstate Commerce Commission seeking additional compensation for the carriage of mail, and in December of that year the Commission found that the rates in effect were unduly low, and awarded an interim increase of 25 percent, continuing the case for the determination of the amount of its final award.

After protracted proceedings, a final award was made in December 1950 in the amount of $312 million which included the 25-percent interim increase theretofore granted.

Senator BYRD. What was that percentagewise?

Mr. FORT. What was that percentagewise? It was in the neighborhood of 50 percent altogether in the final award; 25 percent as an interim increase, and then an additional increase.

Senator BYRD. The permanent increase was around 50 percent?

Mr. FORT. Yes, sir. You will see figures that will sustain that in a moment, Mr. Chairman.

Senator BYRD. All right.

Mr. FORT. Amounts resulting from the interim increase of 25 percent, which in round figures totaled $160,000,000, were received by the railroads in the several years 1947 to 1950, in which the services were rendered, and were included in the tax returns for those respective years.

The remainder of the award, namely, $152,000,000, represents additional compensation for the services rendered in the period 1947 to 1950.

In other words, the additional amounts payable under the final award merely supplement the payments made in each of the years involved under the interim award, which latter amounts, as stated, were included in the income in each of the respective years.

In December 1950 the railroads submitted to the Commissioner of Internal Revenue a request for a ruling that the additional pay awarded in 1950 is properly to be accrued for Federal income-tax purposes in the years during which the services were rendered, namely, 1947, 1948, 1949, and 1950. This request is still pending.

We think the case clearly is one for administrative handling, particularly in view of the fact that in his most recent ruling concerning the accrual of back mail pay, the Commissioner authorized the airlines, which had obtained a like award from the Civil Aeronautics Board, to account for the revenues in the years in which the service was performed.

The railroads are under legal obligation to transport mail pursuant to the provisions of the Railway Mail Pay Act, and by the express terms of the act are entitled to receive fair and reasonable compensation for such transportation.

Certainly for tax purposes the railroads should be permitted to allocate to the years in which the service was rendered the payments made at a later date but representing compensation for that service.

A measure of hardship will be involved even in the event of a favorable administrative ruling in that interest will be payable upon the deficiencies involved. This interest factor, of course, becomes of increasing importance with the passage of time.

In these circumstances, should a ruling be much longer delayed, or should an unfavorable ruling be made by the Commissioner, the railroads will seek an opportunity to urge an amendment of the tax bill to afford legislative relief.

We are hopeful, however, that the matter may shortly be disposed of through an administrative ruling.

That concludes my statement, sir.

Thank you for your courtesy.

Senator BYRD. Thank you very much, Mr. Fort.

(The prepared statement of J. Carter Fort follows:)

STATEMENT OF J. CARTER FORT, VICE PRESIDENT AND GENERAL COUNSEL OF THE ASSOCIATION OF AMERICAN RAILROADS

My name is Carter Fort. I am a lawyer with offices and residence in Washington, D. C. I appear here for the Association of American Railroads, of which I am vice president and general counsel. That association is a voluntary nonprofit organization including in its membership almost all of the class I railroads of the United States—that is to say, railroads having annual operating revenues of $1,000,000 or more. Its membership comprises railroads operating approximately 95 percent of the road mileage of all railroads in the United States and having approximately 95 percent of the total gross revenues of all the rail carriers of the country.

I shall confine myself to the discussion of a limited number of the features of the pending tax legislation which are of special concern to the railroads.

THE CORPORATE TAX RATE

The first subject I shall discuss is the matter of the corporate tax rate.

It goes without saying that rail transportation is a primary essential to both the civilian economy and the national defense. In the present emergency period, the railroads are called upon to undertake a heavy program of capital expansion, through acquisition, at current high costs, of large numbers of new freight cars and much additional motive power and the enlargement of their fixed properties to meet the exigencies of the present and prospective emergency.

There are only two sources of funds for capital expenditure, namely, investment capital and earnings. In the case of the railroads, the availability of investment capital under existing conditions is in large measure limited to borrowings for expenditures for unencumbered new equipment, because fixed property is already mortgaged and the level of railroad earnings is not such as to attract equity capital. At the now existing burdensome level of corporate tax rates, the availability of earnings as a source of funds is severely, even critically, restricted by the circumstance that it takes $1.90 of net income to produce $1 for capital expenditure, after deduction of 47 percent for Federal income taxes.

In these circumstances, it will hardly be a cause for surprise that the railroads view with great concern the provision of the House bill, H. R. 4473, which would exact in the form of Federal income taxes more than one-half of each dollar of net income, and would, indeed, carry the rate to the unprecedented level of 52 percent. Just how the railroads could carry such a tax burden and at the same time meet the imperative requirements of the present emergency it is difficult to comprehend.

The railroads, therefore, associate themselves with those who have appeared before your committee in opposition to any further increase in the corporate tax rate.

In the case of the railroads, the menace of an insupportable burden of Federal income taxes is even more serious than in the case of general industry. To some extent, at least, industries in general are in a position to ride with the business cycle, through curtailment of operations and adjustment of price as circumstances may indicate. Railroads do not have the same freedom to discontinue or curtail operations, even though they be unprofitable, nor can they adjust their charges to variations in their costs without prior authorization of sundry regulatory agencies, with the inevitable procedural delays involved in the process.

The regulatory system under which the railroads operate not only requires that the price of their services be fixed but also affects nearly all their other activities. Under that system the railroads, during the 30-year period 1921–50, have had to function on an average rate of return on depreciated investment of approximately 3.64 percent. In the decade of the 1940's, which included the peak World War II traffic years, the rate of return averaged 4.11 percent, while in the decade ending with 1939, the average was only 2.30 percent. During the five postwar years, 1946–50, when business activity was great and corporate earnings in general were at a high level, the rate of return for the railroads average only 3.51 percent.

With this history in mind, it is small cause for wonder that equity capital is largely unavailable to the railroads and that earnings must be looked to as a principal source of funds for railroad upkeep and expansion. In view of the imperative current need for adequate maintenance and substantial expansion of the railroad plant, we respectfully suggest that nothing short of the most dire necessity could justify an increase in the rate of Federal income taxes imposed upon the railroads. The present rates are all but insupportable. In our considered judgment, there is no justification for entertaining a proposal to take away in Federal income taxes more than one-half of corporate net income, as is proposed in H. R. 4473.

By the same token, we oppose the increase in the over-all ceiling upon Federal taxes from 62 percent to 70 percent, as provided in the House bill.

Highly objectionable also, in our view, is the retroactive feature of the House bill, whereby the increased rates would apply beginning January 1 of this year, although it seems certain that the tax bill will not be enacted until September or even later. In the case of individuals, the House bill avoids retroactivity by in effect deferring until September the proposed increase in rates. It is certainly no less important that retroactivity be avoided in the case of corporations. As to the railroads, their books are kept on the accrual basis and their budgets are on the basis of current tax rates, allocating to capital improvements revenues not needed to meet operating expenses, taxes, interest, and relatively minor distributions to stockholders by way of dividends. A retroactive increase in taxes can hardly fail to bring about serious curtailment in capital improvements already planned and even already actually in progress. Obviously such a result would not be in the interest of national defense.

There is another feature of a retroactive tax increase, in its application to railroads, which should not be overlooked. The charges received by railroads for their services are fixed by governmental authorities, and this, of course, is generally true also of the charges of all public utilities. The level of such charges is not fixed, and could not be fixed, with any reference to a possible retroactive increase in taxes which might be accomplished by a law to be enacted at some future date. Neither could increases in railroad charges, granted subsequent to the enactment of the tax law, be made retroactive to correspond to the retroactive tax increase. Thus, a grossly inequitable situation would arise, which would not only work an irreparable injury to the railroads but would also operate adversely to the public interest in an adequate and efficient national transportation system. If a policy is to be adopted of making tax increases retroactive it will render difficult, if not virtually impossible, any orderly and constructive regulation of railroad rates and the rates of other utilities by the governmental agencies which have been set up for that purpose.

THE SINGLE SURTAX EXEMPTION

I come now to the single surtax exemption provisions of the House bill.

As we understand it, a principal purpose of the provision in section 123 of the House bill, restricting a group of affiliated corporations to a single surtax exemption and a single minimum excess-profits credit, is to prevent tax avoidance through the artificial division of a single enterprise into a number of so-called split-off or spin-off corporations created to obtain the benefit of a separate surtax exemption and a separate excess-profits credit for each. The Report of the Ways and Means Committee of the House indicates that the split-off device came into considerable use during World War II and may be expected to become more prevalent under the incentive of current high corporate tax rates.

We do not quarrel with a purpose to curtail tax avoidance through artificial division of a single enterprise into a chain of separate corporate entities, but the provision of the House bill reaches far beyond such a purpose. It would reach many corporate set-ups of long standing created as a result of legal requirements or by reason of wholly legitimate business considerations quite apart from tax avoidance.

In the case of the railroads, virtually all of these corporate relationships are of long standing and antedate any possible motive to split off corporations for tax-avoidance purposes.

Public convenience and necessity require that railroads operate across State lines. But the provisions of law in some States have necessitated, as a practical matter, the existence of subsidiary corporations. For example, where a State has prohibited railroad property from being owned by a foreign corporation or has refused to grant the power of eminent domain to foreign corporations, it is apparent that a separate corporation had to be continued or created under the laws of that State. The result has been that the major railroad systems of this country have developed not only by mergers but also by a process of leasing railroad properties which form an integral part of the operating system of the lessee. In the railroad field, therefore, multiple corporate set-ups are the rule rather than the exception, but this is in no sense the result of artificial splitting off with an eye to the tax laws.

We strongly urge, therefore, that if the single exemption feature of the House bill is to be retained it be modified to apply only to corporations created subsequent to a specified date; say, October 8, 1940, the date of enactment of the Second Revenue Act of 1940, when the World War II excess-profits tax was first imposed. Prior to that date there could have been no motive for corporate split-offs for the purpose of obtaining additional exemptions or credits. We would also suggest further amendment to make the single exemption provision inapplicable to corporations created after the date selected in those instances where it is shown to the satisfaction of the Commissioner that the corporation was created for legitimate business purposes other than tax avoidance.

Thus amended, section 123 of the House bill would be confined in its scope to the effectuation of a purpose to discourage split-offs for tax avoidance and the section would not be applicable where no element of tax avoidance is involved.

WITHHOLDING ON DIVIDENDS AND INTEREST

The railroads are in complete agreement with the premise that taxes should be paid upon all taxable income and that all reasonable means should be used to prevent an escape from the payment of taxes either by individuals or corporations and whether as a result of underreporting of dividends and interest or otherwise. However, they question the advisability of further transferring the tax-collecting function from the Treasury to corporations.

There is no question, it seems to us, but that serious hardship will result in many instances from the want of relationship between the amount withheld and the amount of taxes due, if any. Many taxpayers will be put to the necessity of procuring refunds and will be deprived of the use of their money, at least for a season.

In important instances, indeed, overwithholding would be inevitable. A case in point is the payment of dividends to corporations. These dividends are taxable to the extent of 15 percent of their amount. Assuming a combined normal tax and surtax rate as high, even, as the 52-percent rate proposed in the House bill, the tax would not exceed 7.8 percent, yet 20 percent would be withheld. In many instances this result, and the attendant delay in obtaining a refund, would seriously impair the working capital of the recipient corporation. This situation would seriously affect many railroads. To ameliorate this particular hardship it would seem that, if withholding on dividends is to be required, the corporate recipient of dividends should be permitted to set off the amount withheld against any amount due from such corporation as income or payroll taxes, along the lines of the provision in the House bill with respect to tax-exempt organizations.

The House bill would exempt from withholding, among other things, interest on equipment-trust certificates. The report of the Ways and Means Committee of the House indicates that the reason for exemption of equipment-trust certificates from the requirement of withholding is that they are ordinarily held by corporations. Conditional-sales agreements are widely used by railroads in financing the acquisition of new equipment. They serve in that connection the same purpose as equipment-trust agreements. Like equipment-trust certificates, they are ordinarily held by corporations. Unpaid balances on such agreements entered into by railroads aggregated slightly in excess of $392 million as of December 31, 1950. We urge that, if a withholding requirement is to be retained in the bill, the exemption with respect to interest on equipment-trust certificates be enlarged to include interest payable under conditional-sales agreements.

But we think that in any event the requirement of tax withholding as proposed in the House bill should be deferred until the effect of the new reporting requirements can be known. This year, for the first time, under regulations of the Commissioner, corporations are required to report all payments of dividends, regardless of amount, and the recipient taxpayer is required to itemize all dividends received. No opportunity has been afforded as yet to judge the efficacy of these measures in minimizing the evil at which the proposed withholding is directed. Until that is known, we think your committee is not in a position to gage the extent of the evil and to measure the benefits of the proposal against the hardships inherent in it.

THE PENALTY FOR FILING CONSOLIDATED RETURNS

The railroads have frequently urged upon your committee and upon the Ways and Means Committee of the House repeal of the 2-percent penalty for filing consolidated returns. In practical effect, the impact of this penalty is, of course, increased sharply as the corporate tax rates rise. We think the penalty without justification in any event; but, when consideration is being given to a bill which would place the combined corporate normal and surtax rate at 52 percent, it is especially important, we think, that your attention be directed to the fact that the combined rate under such a measure would reach 54 percent in the case of consolidated returns and leave a bare 46 percent of net earnings available for corporate purposes.

The exigencies of the present situation, therefore, impel us to again urge the repeal of this penalty.

It may be taken for granted, we suppose, that under existing emergency conditions and the consequent revenue needs of the Government the combined corporate normal and surtax rate will be fixed at the maximum figure deemed consonant with the preservation of a sound and vigorous economy. It this be so, it follows that the exaction of a penalty of two additional percentage points in the rate would in many cases carry the rate to a level higher than the maximum regarded by Congress as justifiable. And yet consolidated returns are consonant with the principle of levying taxes according to the true net income of a single enterprise, and they have, as we understand, been favorably regarded by the Treasury from the administrative standpoint.

The imposition of a penalty for filing consolidated returns is particularly inappropriate in the case of the railroads. Most of the major railroad systems, as already pointed out, have of necessity been built up through the combination of a number of comparatively small railroads. By reason of sundry controlling factors, including in many cases the requirements of State law, it has often been impossible to effectuate integration through consolidation or merger. The continuance of subsidiary corporate entities has frequently been a practical or a legal necessity, and the acquired properties in such cases have been integrated into the operating system through long-term leases or by other means. Multiple corporate entities within a single railroad system have thus resulted as an incident to the process of evolving a limited number of railroad systems capable of rendering a national transportation service in accordance with the requirements of the national economy and the dictates of the national transportation policy.

At times in the past, Congress has recognized the special situation of the railroads with reference to consolidated returns. Thus, when consolidated returns were abolished insofar as other businesses were concerned by the Revenue Act of 1934, railroads, because of their special situation, were still permitted to file them. From 1934 to 1939 railroad companies alone were permitted to file consolidated returns, and in 1940 and 1941 railroads alone were permitted to file consolidated returns with respect to normal taxes and surtaxes, other corporations being confined to consolidated returns for purposes of excess-profits taxes. During the latter years mentioned, no penalty was exacted.

We think that on principle the penalty should be removed as to all corporations, but in any event we submit that the particular situation of the railroads should be recognized under present conditions and the penalty eliminated as to them.

A SUGGESTED AMENDMENT OF THE EXCESS PROFITS TAX ACT OF 1950

We understand that your committee may conclude to defer until next year any revision of the Excess Profits Tax Act of 1950 but that suggestions for revision are acceptable now for consideration at such time as that act may come under review. The railroads do not urge that the Excess Profits Tax Act be considered now. They are in accord with the thought that the matter would better be deferred until there has been more adequate experience under the act as it stands. They are concerned, however, that at the appropriate time consideration be given to what may be a serious defect in the act as it affects them in one important respect. It has to do with the status of long-term lessor and lessee railroad companies with respect to the availability of consolidated returns. The apprehension is that under the technical provisions of the Excess Profits Tax Act consolidated returns may be available to these corporations only in the event the lessee (the operating company) foregoes the public-utility excess-profits credit provided for by section 448 of the act.

It is not believed that such a result was anticipated or intended. A simple clarifying amendment would prevent it. I do not seek to go at length into the matter here and now, but ask that a brief statement with respect to it be incorporated at this point in the record as a part of my testimony.

(The statement to be copied into the record, but not read, is as follows:)

PROPOSED AMENDMENT OF SECTION 448 OF THE EXCESS PROFITS TAX ACT OF 1950 IN RESPECT OF CERTAIN LESSOR RAILROAD CORPORATIONS

Section 448 of the Internal Revenue Code provides an alternative excess-profits credit for regulated public utilities. This credit, in the case of railroads, is measured by a return of 6 percent upon net assets after allowance for normal tax and surtax liabilities. To be entitled to this alternative credit a railroad corporation must be engaged as a common carrier in the furnishing or sale of transportation by railroad, subject to the jurisdiction of the Interstate Commerce Commission, and at least 80 percent of its gross income (computed without regard to dividends and capital gains and losses) must be derived from the furnishing or sale of transportation by railroad (sec. 448 (c) (3); 448 (d)).

Section 141 of the Internal Revenue Code, as amended by the Excess Profits Tax Act of 1950, provides for the filing of consolidated returns by affiliated corporations which are regulated public utilities within the meaning of section 448.

We believe that the law should be clarified to make certain that a lessor railroad corporation which leases substantially all of its property to an operating lessee railroad corporation which utilizes the public-utility credit may be joined with such lessee in the filing of a consolidated return. Although the lessor company is subject to the jurisdiction of the Interstate Commerce Commission, and its properties are operated by the lessee as integral parts of its system in the furnishing or sale of transportation by railroad, and its revenues, in the form of rental, derive from such operations, nevertheless the lessor does not itself operate the property and it does not derive its revenues directly from the furnishing or sale of transportation. It should be made clear that section 141 of the code does not preclude the lessee from joining the lessor in a consolidated return, except at the sacrifice of the alternative credit to which the lessee is entitled under section 448.

It is believed that Congress did not intend that the consolidated return provisions applicable in the case of these lessor-lessee railroad relationships should operate as a barrier to the availability to the lessee of the special public-utility credit, or that utilization of that credit by the lessee should preclude a consolidated return.

As has already been stated, most of the major railroad systems today are the result of the combination of a number of comparatively small railroads. In many cases, substantial obstacles have prevented the merger and consolidation of these smaller companies into one large corporation. Among these obstacles are State laws; franchise rights; rights of minority stockholders; and mortgage, lease, and contract provisions. As a result of these and other considerations, the major railroad systems of the country have developed not only by mergers and consolidations but in substantial part through long-term lease arrangements.

Under an arrangement of the latter type the company which owns the properties leases them for a long period of years to an operating company. Thereafter the lessor ceases operations, although it continues its corporate existence, receiving rental for the use of its properties ordinarily measured by the requirements of interest on the indebtedness of the lessor and dividends on its capital stock.

The lessee takes over the complete management and control of the properties of the lessor and incorporates them into its railroad system. The facilities of the lessor and lessee become integrated parts of a single unified system. It is then not possible to determine for any given period of operation the amount of income attributable to the operations of the leased properties and the amount attributable to the operations of the properties owned by the lessee. Revenues and expenses have become amalgamated. The properties of the respective corporations are regarded as a unit by the Interstate Commerce Commission for rate-making an other regulatory purposes, and the value of the properties of the lessor is included in the rate base of the lessee, the operating company.

There is thus presented the typical case for a consolidated return, and there is certainly no reason why it should be available only at the cost to the lessee of the alternative public-utility credit.

It is accordingly urged that section 448 (d) be amended by adding at the end thereof a clarifying provision that, for the purposes of section 448 and of section 141, a railroad corporation which has leased substantially all of its property to a common carrier shall be deemed to be a common carrier engaged in the furnishing or sale of transportation and that the rents receivable under such a lease shall be considered to be derived from the furnishing or sale of transportation.

Under such an amendment any possible impediment to consolidated returns would be removed where at least 80 percent of the lessor's income was derived from rentals under the lease.

The untoward and, it is believed, unintended deprivation in the typical railroad lessor-lessee relationship of the right to file a consolidated return and utilize the regulated public-utility credit would be obviated.

The suggested amendment is submitted with confidence that it accords with the policy embodied in section 448 and eliminates a possible obstacle to the filing of consolidated returns which ought not to be interposed in the case of railroad leases of the character described.

(End of statement to be copied into the record but not read.)

ALLOCATION FOR TAX PURPOSES OF BACK MAIL PAY TO THE YEARS IN WHICH THE MAIL WAS TRANSPORTED

There is one additional matter which I am constrained to call to the attention of your committee because the railroads may be compelled at a somewhat later date to request an amendment of the tax bill with respect to it. The situation to which I refer is this:

In February 1947 the railroads filed an application with the Interstate Commerce Commission seeking additional compensation for the carriage of the mail, and in December of that year the Commission found that the rates in effect were unduly low and awarded an interim increase of 25 percent, continuing the case for determination of the amount of its final award. After protracted proceedings a final award was made in December 1950 in the amount of $312 million, which included the 25-percent interim increase theretofore granted.

Amounts resulting from the interim increase of 25 percent, which in round figures totaled $160 million, were received by the railroads in the several years 1947 to 1950, in which the services were rendered, and were included in the tax returns for those respective years. The remainder of the award—namely, about $152 million—represents additional compensation for the same services rendered in the period 1947–50. In other words, the additional amounts payable under the final award merely supplement the payments made in each of the years involved under the interim award, which latter amounts, as stated, were included in income in each of the respective years.

In December 1950 the railroads submitted to the Commissioner of Internal Revenue a request for a ruling that the additional mail pay awarded in 1950 is properly to be accrued for Federal income-tax purposes in the years during which the services were rendered; namely, 1947, 1948, 1949, and 1950. This request is still pending.

We think the case clearly one for administrative handling, particularly in view of the fact that in his most recent ruling concerning the accrual of back mail pay the Commissioner authorized the airlines, which had obtained a like award from the Civil Aeronautics Board, to account for the revenues in the years in which the service was performed.

The railroads are under legal obligation to transport the mails pursuant to the provisions of the Railway Mail Pay Act, and by the express terms of the act are entitled to receive fair and reasonable compensation for such transportation. Certainly for tax purposes the railroads should be permitted to allocate to the years in which the service was rendered the payments made at a later date but representing compensation for that service.

A measure of hardship will be involved even in the event of a favorable administrative ruling, in that interest will be payable upon the deficiencies involved. This interest factor, of course, becomes of increasing importance with the passage of time.

In these circumstances, should a ruling be much longer delayed, or should an unfavorable ruling be made by the Commissioner, the railroads will seek an opportunity to urge an amendment of the tax bill to afford legislative relief. We are hopeful, however, that the matter may shortly be disposed of through an administrative ruling.

Senator BYRD. The next witness is Mr. William Neff.

Mr. Neff, will you identify yourself to the reporter, please?

STATEMENT OF WILLIAM NEFF, SECRETARY AND GENERAL MANAGER, THE VANCE CO., INC.

Mr. NEFF. Senator Byrd, and gentlemen of the committee, I am William Neff, secretary and general manager of the Vance Co., Inc., of Chilhowie, Va.

Senator BYRD. Mr. Neff, you have been assigned 10 minutes.

Mr. NEFF. I think that will be enough, thank you, Senator Byrd.

Senator BYRD. Proceed.

Mr. NEFF. I am speaking for the Vance Co. of Chilhowie, Va., which is a small company, operating 12 retail stores in the southwest part of the State's agricultural section.

The company is, itself, an operating and also a parent corporation. It owns a hundred percent of five companies and less than 95 percent of—considerably less than 95 percent—two others.

The company has a sales volume of a little less than $3 million; its capital is $835,000, and it has 174 stockholders, no 1 of which—well, the largest stockholder owns 14 percent of the stock, and the others lesser amounts, and the stockholders are widely separated in the different counties in which we operate. They are not concentrated.

I am submitting a statement for the benefit of the committee, and attaching to it sheets which show the relation of the parent company to the subsidiary, and also showing the sales, the net taxable income, and the income taxes for the year 1950.

Senator BYRD. What you do not cover in your oral statement will be included in the record.

Mr. NEFF. Yes.

I will not, of course, give that orally, but it is attached to the statement, and showing the effect of the House bill H. R. 4473, especially section 123 on our taxes.

Our position is that we are not opposing the increase in corporate income taxes due to the higher rates that are proposed in H. R. 4473, if the increased revenue is needed and necessary to pay for the defense of our country.

We favor meeting these costs on a pay-as-you-go basis so as to avoid increasing the national debt and further inflation. The proposed increased rates alone, not counting 123, would mean for our eight companies an increase in our Federal income tax of about 25 percent as compared with the taxes in 1950. This is a heavy increase, but we are willing to bear it if it is necessary, and if other taxpayers are required to carry their part of the burden.

We would prefer that economies in Government expenditures be effected to make possible a smaller increase in taxes.

We need this extra money badly to replace equipment and to pay debts which we have incurred to carry inventories at inflated prices now prevailing.

I would express the hope that the committee may find it possible to balance the budget at lower tax rates than those proposed.

We wish, however, to register our emphatic opposition to the provisions of section 123 as applied to "related corporations," especially as defined in the bill, section 123, as members of a group of corporations, 95 percent or more of the stock of which is owned by one corporation of the group. This section provides that for all the members of such a group, there shall be only one $25,000 exemption for surtax.

Senator MILLIKIN. How long have your separate companies been organized?

Mr. NEFF. As I will bring out, they date back to the beginning, in 1907, and it has occurred through that period. Attached to my statement is a schedule showing just when each one was organized.

The same provision is applicable to excess-profits tax, but our interest in that is purely theoretical at this time, although we would object to that in principle—we might get in those brackets sometime.

We will illustrate the effect of this section by its application to our business, which I am treating as a case in question.

As defined in section 123, the Vance Co. and five of its subsidiaries are related corporations. For these six companies as shown in the attached schedule, the Federal income tax in 1950 was about $43,000, using round figures.

Under the rates proposed in H. R. 4473, under the rate change alone, this tax would be changed over 27 percent, and under the provisions of section 123 there would be a further increase of about $17,000 for those companies, or a total increase of 67 percent.

Senator MILLIKIN. What degree of independence do your separate companies have?

Mr. NEFF. I beg your pardon?

Senator MILLIKIN. What degree of independence do your separate companies have?

Mr. NEFF. Each one has its own board of directors, its own officers, although the officers are interlocking to some extent. They do bring in local stockholders because we have stockholders in each locality. They have their own managers; they have generally local employees, and they are closely tied in with their community.

In general, our ownership for part of them has succeeded the existence of previous corporations that we acquired usually to bail out the owners who are not doing so well, and who want to sell out.

Now we treat them, and we think of them, as community stores which are associated by over-all common policies.

Senator MILLIKIN. They do not follow a rigid pattern of direction imposed by the mother company?

Mr. NEFF. No. We do not operate on commonly called chain-store principles. We think of it as a group of stores rather than as a chain of stores.

Senator BYRD. How many stores in all?

Mr. NEFF. There are 12 altogether.

As I just said, with the application of section 123, our taxes would be increased 67 percent over what they were in 1950, and the increase due to section 123 would be approximately 144 percent of the increase due to the change in rates.

We submit that that is an excessive increase in taxation for such a group of companies.

Now, answering Senator Millikin's questions, I have a brief statement on the attached sheet, upon which is shown the relation of the subsidiaries to the Vance Co., the parent company.

They were not set up as separate corporations for tax-avoidance purposes. The business policy of operating the stores in each location as separate corporations dates back to 1907 before any tax benefit existed.

With one exception, each continued or succeeded existing corporations. Each is located in a different town, and each is a community store with its own management, own employees, services, and community responsibility.

They are not operated on the chain-store principle, but as a group of community stores.

Senator BYRD. Do you make purchases from a central point?

Mr. NEFF. We make some group purchases, as a central—probably, oh, 20 percent of the purchases are bought as a group. The remainder are bought by the individual store management.

Their status as separate tax entities has been recognized all these years. To change the rules of the game now, and to reverse established tax policy in regard to long-standing corporate relationships and impose such a heavy tax increase as is proposed in section 123 seems unfair and unduly burdensome.

If it were proposed in the bill to prevent future split-ups from getting tax advantages, we would have no objection.

Our objection is to changing established tax policies in reference to corporations which have been set up for a long time.

Senator MILLIKIN. You have a little difficulty there. I am in complete sympathy with the general purport of your statement. But when it comes to the future, if you have a future rule prohibiting what has happened in the past and, let us say, has become legitimatized in the past, why then, the future companies are at a disadvantage against those that have been established that way.

Mr. NEFF. Yes; except that it can be so defined, it seems to me that the purpose of tax avoidance can be distinguished from sound business reasons, not associated with that.

I believe that principle is already in the law and it was incorporated in the Excess Profits Tax Act of 1940.

Senator MILLIKIN. You have the future group subject to discretion, and the past group not subject to discretion?

Mr. NEFF. Well, it seems to me there is some obligation to existing corporate set-ups in the fact that they have been organized and they have operated under that basis.

Senator MILLIKIN. I agree with that.

Mr. NEFF. And all of their commitments and everything have been made on that basis.

Senator MILLIKIN. I am in complete sympathy with that.

Mr. NEFF. And those in the future would go into it with their eyes open and hence it seems to me, would be in a different status.

I understand it is estimated that the changes in section 123 would yield $55,000,000 additional revenue. This is a considerable sum of money, but it is small in comparison with the estimated yield of the whole bill, about three-quarters of 1 percent of the whole amount.

It seems unreasonable that this comparatively small amount of revenue should be obtained by changing established rules to impose such a heavy increase on a limited group of taxpayers whose burden is already heavy.

We feel that it would be more equitable to secure the needed revenue by collecting income taxes from some tax-exempt organizations, who are competing with us—I will not go into that. I think the committee has heard something about that.

There already exists a very considerable tax penalty—and I think this is a point—or liability due to the operation of such a group as separate corporations in the tax on 15 percent of intercompany dividends.

Again, to illustrate by our company, there is in the taxable income of the Vance Co. for 1950 the amount of $19,729, which is 15 percent of dividends received from subsidiaries.

The income on this amount at the 52 percent rate would be $10,259.

Now this seems a sufficient tax penalty incident to that kind of operation, without adding another $17,000 by changing the rules as proposed in section 123.

In other words, we are already paying taxes because of our intercompany operations, a considerable amount of them, and to put this other on would be adding burdens on top of burdens.

This is a statement which I hesitate to make, but I think it is true. As a matter of fact, section 123 may be characterized as a nuisance provision rather than a revenue-raising law. The tax yield has been estimated at $50 million.

Well as a matter of fact, I think it would be very much smaller, very much smaller indeed. The burden imposed on the companies affected is so heavy that they would be compelled to change their corporation relationships and that would be so true that the yield from the bill, I think, would be very small indeed, and the result then of this enactment would not be the raising of revenue but just compelling a lot of companies to change corporate relationships which have been in existence for many years and which have sound reasons for existing, as illustrated by the gentleman who preceded me, and it is certainly in our case and I am sure many others.

Senator MILLIKIN. Mr. Stam, how much revenue do they figure they can get under the House provisions?

Mr. STAM. I think the estimate is $55,000,000.

Senator MILLIKIN. $55,000,000.

Mr. NEFF. My statement is that because of the changes that would be made that would be very much smaller. In fact, I think it would practically vanish, but we would have a lot of disturbance in corporate relationships. These are some of the reasons, and I can name many others—but I think my time is about up—why we oppose the changes in section 123.

We respectfully request the committee to omit the provisions of that section which radically changes a long-standing tax policy and imposes such a burdensome tax increase on the related corporations affected by it.

We repeat the hope that the committee may find it possible by economies in expenditures or by taxing presently tax-exempt business to even reduce the tax rates proposed in H. R. 4473.

Senator BYRD. Thank you very much, Mr. Neff. The balance of your statement will be put in the record.

(The statement of Mr. William Neff referred to follows:)

STATEMENT OF WILLIAM N. NEFF, SECRETARY AND GENERAL MANAGER OF THE VANCE CO., INC., CHILHOWIE, VA.

I am speaking for the Vance Co., Inc., of Chilhowie, Va., which is both an operating company and a parent corporation. It operates a fertilizer-mixing plant and retails hardware, farm, and building supplies. Its subsidiaries are all located in southwest Virginia and operate retail stores selling similar lines of merchandise. The Vance Co. owns 100 percent of the stock of five companies and less than 95 percent of two others.

I am submitting attached to this statement sheets showing the relation of these companies to the parent company and how they were acquired, and also a sheet showing for the year 1950 for each company, its sales, its net taxable income, the actual Federal income taxes for that year, and what those taxes would be under the rates and other provisions, especially section 123, of H. R. 4473.

Our position is that we are not opposing the increase in corporation-income taxes due to the higher rates set up in H. R. 4473 if the increased revenue is needed and necessary to pay for the defense of our country. We favor meeting these costs on a pay-as-you-go-basis, so as to avoid an increased national debt and further inflation.

The proposed increased rates alone would mean for our eight companies on our 1950 income an increase in Federal income taxes of $22,170.64, or a 21.7-percent increase compared with the actual taxes for 1950. This is a heavy increase. We are willing to bear it if it is necessary and if other taxpayers are required to carry their part of the burden.

We would greatly prefer, however, that economies in Government expenditures be effected to make possible a smaller increase in these taxes. We need the money badly to replace old equipment and to pay debts incurred to carry inventories at inflated prices. I would express the hope that the committee may find it possible to balance the budget at lower tax rates than those proposed in H. R. 4473.

We wish, however, to register emphatic opposition to the provisions of section 123 as applied to "related corporations," defined as the members of a group of corporations 95 percent or more of the stock of which is owned by one corporation of the group. This section provides that, for all the members of such a group, there shall be only one $25,000 exemption for surtax. The same provision is applicable to the excess-profits tax, but our interest in that is purely academic at this time, although we would oppose it in principle.

We will illustrate the effect of this section by its application to our business. As defined in section 123, the Vance Co. and five of its subsidiaries would be "related corporations." For these six companies, as shown in the attached schedule, the Federal income tax in 1950 was $42,835.22. Under the rates proposed in H. R. 4473, this tax would be increased $11,746.97, or 27.4 percent. Under the provisions of section 123 there would be a further increase of $16,863.16, or a total increase of 66.8 percent over 1950. The increase due to section 123 is approximately 144 percent of the increase caused by the higher rates. We submit that this is an excessive increase in taxation for such a group of companies.

On an attached sheet is shown the relation of the subsidiaries of the Vance Co. to the parent company. They were not set up as separate corporations for tax-avoidance purposes. The business policy of operating the stores in each location as separate corporations dates back to 1907, before any tax benefit existed. With one exception, each continued or succeeded existing corporations. Each is located in a different town, and each is a community store with its own management, employees, services, and community responsibility. They are not operated on the chain-store principle, but as a group of community stores. Their status as separate tax entities has been recognized all these years. To change the rules of the game now, to reverse established tax policy in regard to long-standing corporation relationships, and impose such a heavy tax increase as is proposed in section 123 seems unfair and unduly burdensome.

I understand it is estimated that the changes in section 123 would yield $55,000,000 additional revenue. This is a considerable sum of money, but small in comparison with the estimated yield of the whole bill, about three-fourths of 1 percent of it. It seems unreasonable that this comparatively small amount of revenue should be obtained by changing established rules to impose such a heavy increase on a limited group of taxpayers whose burden is already heavy.

We feel that it would be more equitable to secure the needed revenue by collecting income taxes from cooperatives and other tax-exempt business who now operate tax-free in direct competition with us.

There already exists a very considerable tax penalty or liability due to operation of such group as separate corporations in the tax on 15 percent of intercompany dividends. Again to illustrate by our company, there is in the taxable income of the Vance Co. for 1950 the amount of $19,728.90, which is 15 percent of dividends received from subsidiaries. The income tax on this amount at the 52 percent rate proposed in H. R. 4473 would be $10,259.03. Is not this a sufficient tax penalty incident to such operation without adding another $17,000 by changing the rules as is proposed to be done by section 123?

As a matter of fact, section 123 may be characterized as a nuisance provision rather than a revenue-raising law. The tax yield would probably be very small, much less than the $55,000,000 estimated. The burden imposed by that section is so heavy that the groups affected would almost surely rearrange corporate relationships to save taxes. By operating as one corporation instead of separate corporations, the tax on intercompany dividends can be avoided; or, by disposing of a small part of the stock owned in subsidiaries, the provisions of section 123 can be avoided. Either of such actions will result in making the net yield of the proposed change very small. The final result would be little revenue but troublesome and undesirable changes in corporate set-ups which have been established and should be continued for sound business reasons. We submit that this change in tax law would have a serious nuisance effect, but would yield little net increase in revenue and should not be made.

These are some of the reasons, and I could name others, if time permitted, why we oppose the proposed changes in section 123. We respectfully request the committee to omit the provisions of that section, which radically changes long-standing tax policy and imposes such a burdensome tax increase on the related corporations affected by it. We repeat the hope that the committee may also find it possible by economies in expendiutre or by taxing present tax-exempt business to reduce the tax rates proposed in H. R. 4473.

History of the Relation of the Vance Co., Inc., the Parent Company, and its Subsidiaries

Corporation Z, which is the Vance Co., Inc., of Chilhowie, Va., was incorporated in 1920 as the successor of corporation X, a retail hardware business, which began in 1903 as a partnership, but became a corporation in 1912. Corporation Z in 1926 merged with corporation Y, a farm-supply business in the same town, which began as a partnership in 1902 and was incorporated in 1907.

Corporation Z and its subsidiaries are all located in different towns in the southwestern part of Virginia and are engaged in the retail selling of hardware, building, and farm supplies. Corporation Z owns 100 precent of the stock of corporations A, B, C, D, and E, 90½ percent of corporation M, and 57.6 percent of corporation N. These interests were acquired as follows:

Corporation A of Marion, Va., was organized in 1910 and was consolidated with another hardware business in that town purchased by corporation Y in 1920 and acquired by corporation Z in the 1926 merger.

Corporation B of Glade Spring, Va., was organized in 1915, and its stock at different times was acquired by corporation X and sold to corporation Z in 1920.

Corporation C of Saltville, Va., was organized as a wholly owned subsidiary by corporation Z in 1949.

Corporation D of Rural Retreat, Va., was organized in 1935 by corporation Z to take over a farm-supply business and a hardware business, both of which had been operated as corporations for several years in that town.

Corporation E, of Radford, Va., was organized by corporation Z in 1946 to take over a hardware business in that town which had been operated as a corporation for several years.

Corporation M, of Abingdon, Va., was incorporated in 1907 with a majority of its stock owned by corporation Y to succeed a former corporation of the same town. Corporation Z acquired this interest in the 1926 merger and later purchased additional stock up to its present interest of 90.5 percent.

Corporation M, operating stores in Pulaski, Christiansburg, and Wytheville, Va., was incorporated in 1917 as an outgrowth of former corporations. Corporation Z acquired its interest in corporation M by purchase of stock in 1940 and 1949, now owning 57.6 percent.

It is seen that none of these corporations is the result of split-ups, but they result, except in one case, from acquiring previously existing corporations in different town locations over a long period of years dating back to 1907. Business reasons, not tax avoidance, actuated the separate incorporation of each subsidiary. Each company operates a community store, with its own management, its own books, its own buying and credit facilities, its own directors and officers. Each is an independent operation, except that they follow common over-all policies, do some joint buying, and are under the general supervision of one person. They do not receive their merchandise from a central-distributing warehouse, although they draw stocks from each other, do some group buying, and two of the larger stores keep extra stocks in some lines for the convenience of the others.

The business is not a chain store, but a group of affiliated independent stores.

Federal income taxes of the Vance Co., Inc., and subsidiaries

	Percent stock owned by parent	Sales 1950	Federal tax net income 1950	Taxes on 1950 income: (1) Actual[1]	Taxes on 1950 income: (2) New rates[2]	Taxes on 1950 income: (3) Sec. 123[3]	Increase (2) over (1)	Percent increase	Income (3) over (1)	Percent increase
Corporation Z	(4)	$530,873.45	$66,899.53	$23,347.80	$29,287.76	$29,287.76	$5,939.96	25.4	$5,939.96	25.4
Corporation A	100	363,469.81	29,425.27	7,608.61	9,801.14	15,201.14	2,192.52	28.8	7,602.53	101.1
Corporation B	100	282,054.50	24,229.80	5,568.95	7,289.94	12,635.90	1,700.99	30.4	7,046.95	126.1
Corporation C	100	75,805.32	5,961.78	1,375.81	1,798.71	3,110.52	417.90	30.4	1,734.71	126.1
Corporation D	100	173,821.33	18,552.29	4,267.02	5,565.69	9,647.19	1,298.66	30.4	5,380.16	126.1
Corporation E	100	77,243.50	2,813.15	647.02	843.95	1,462.84	195.93	30.4	815.82	126.1
Subtotal		1,485,275.00	147,971.82	42,835.22	54,562.19	71,445.35	11,746.97	27.4	28,610.13	66.8
Corporation M	90.5	647,101.83	72,685.34	24,568.57	29,713.64	29,713.64	5,145.07	20.9	5,145.07	20.9
Corporation N	57.6	721,849.65	67,438.75	22,234.11	27,512.71	27,512.71	5,278.60	23.7	5,278.60	23.7
Total		2,854,226.68	288,095.91	89,637.90	111,808.54	126,671.70	22,170.64	24.7	39,033.80	43.5

[1] Actual Federal income tax for 1950 at rates affective that year; all corporations on calendar-year basis.
[2] What Federal income tax would have been at rates proposed in H. R. 4473.
[3] What Federal income tax would have been at rates proposed in H. R. 4473 with proposed amendment in sec. 123 limiting exemption to surtax to $25,000 for related corporations Z, A, B, V, C, D, E.
[4] Parent company.

Senator BYRD. The next witness is Mr. F. A. Eustis. Mr. Eustis, will you take a seat, and please identify yourself for the record.

STATEMENT OF FREDERIC A. EUSTIS, TREASURER, VIRGINIA SMELTING CO.

Mr. EUSTIS. My name is Frederic A. Eustis.

I am the treasurer of the Virginia Smelting Co., whose principal business is located at West Norfolk, Va.

Senator BYRD. Mr. Eustis, before you proceed, we have six other witnesses, and we have got an hour within which to hear them.

Mr. EUSTIS. I understand that I have been requested to confine my oral remarks to 10 minutes, and I am going to try to do that.

Senator BYRD. Please try to do it, because there are six other witnesses to follow you.

Mr. EUSTIS. Yes, sir.

Senator BYRD. We will consider your other statemet carefully.

Mr. EUSTIS. The Virginia Smelting Co., which is my principal business, is a moderate-sized manufacturer of chemical specialties whose headquarters are at West Norfolk, Va.

It has approximately 350 employees. It is a modest-sized company, and it has to compete with a great many large companies.

I have handed to your clerk 15 copies of the printed testimony, which I wish to submit to you.

In my 10 minutes I shall try, in my oral presentation, to touch the highlights of this statement.

Senator BYRD. You desire your complete written statement to be put into the record?

Mr. EUSTIS. Please.

Senator BYRD. It will be inserted into the record.

Proceed, sir.

Mr. EUSTIS. I want to first stress the importance in our national economy of the modest-sized growing companies.

My company is one, and I have been asked by four friends who have similar companies in the chemical business to state that they find themselves in the same position that we do.

The very heavy increased taxes on income are a very serious burden to a company that is seeking to grow, and I shall stress more on that later.

During the latter part of my 10 minutes I shall point out to you the great hardship that the present excess-profits tax further creates on my particular company and, also, I am convinced, on many other modest-sized chemical manufacturers, and I would like to leave out "modest sized"—on all chemical manufacturers.

It is actually forcing us to pay now currently up to $52,000 a year additional taxes because we had losses. We had losses in the base period.

It does not seem equitable that the tax law should require a taxpayer to pay heavy additional taxes because of losses, and I shall try to make that clear toward the end of my brief.

My company has grown steadily, slowly, for 35 years. I personally have been connected with it for longer than that.

It has to grow in order to compete with its very much larger competitors. The products we make are 10 different chemical products, and those products are all manufactured by the large chemical concerns; and we have found through our 35 years of experience that the only way we can successfully compete with these giants is to keep growing, and we have continuously reinvested in our business a very large part of our earnings in order to keep our plant up to date and to provide the ability to grow.

The burden which is now placed on us of taking for the Federal Government 62 percent of our income—and we have to pay, of course, some more to Virginia and to local taxes—leaves us distressingly little with which to carry on our growth—to do the things that we have always sought to do.

One of my major efforts in my remarks will be to urge that you not increase further the 62 percent.

I have pointed out that I know my company is not alone in the predicament of suffering from these rather heavy drains on our earnings.

There are four companies controlled by business acquaintances, who have individually asked me to express to your committee their serious concern over the tax burden being put on them by the Federal Government.

These four companies are the R. J. King Co., Inc., Norwalk, Conn., Lotte Chemical & Dye Co., Paterson, N. J.; Magnus Chemical Co., Garwood, N. J.; Purocaine, Inc., Hockessin, Del.

I realize perfectly that five of us are a very small group in our Nation's picture, but I want to stress to you, as urgently as I can, that the growth of the modest-sized companies which are seeking to come up and take their important part in the industry of the country is in the aggregate, tremendously important to the Nation.

If these modest-sized companies are more discouraged, pressed harder on taxes, than the 62 percent, or some such figure, inevitably the result will be to push a larger and larger part of our manufacturing and distributing activities into the hands of the very few large companies.

I realize fully the difficult position in which our Nation finds itself. I realize keenly the threat of communism. I want to do my full part to do everything to help the country to defend itself.

I realize that to do that we have to raise very great amounts of money.

My appeal to you is that you do not push the tax burden on income to the point where the small-growing companies will stop growing.

I urge you as Senators to curtail nondefense expenditures as far as possible, and to distribute the tax burden that is necessary to provide the income you find necessary as far as possible in a way that will not too much stifle the growth of these small-growing companies, which seems to be so important in our national economy.

More specifically, I ask that the maximum Federal tax on corporations, on corporate income, be not increased above the 62 percent of the present law.

I believe the House bill proposes a further increase and one of my principal purposes for coming here is to urge that that 62 percent be kept, and that an increase above that be not allowed.

Gentlemen, the ceiling which is provided by this 62 percent in the case of chemical manufacturers has become practically the tax rate. Any growing concern, with the very limited base that we are granted on our excess profits, 85 percent of what we earn, are mostly—the fellows who are really getting ahead, get up to that 62 percent and if you can realize that, I think you can see how stifling that burden is already, and how much more stifling it will be if you should increase that figure, to the growth of these small, and I think, important companies.

I want to now turn a little to the burden the Virginia Smelting Co. must carry.

Base-period abnormalities occur in all businesses. I know them chiefly in the chemical business. My company, and every chemical company that I know, makes a practice of introducing new products. Some of our older products gradually died.

We are making today two that are just coasting down. We must bring in these new products to replace the disappearing markets. That means that in the chemical world changes are constant, and that to succeed we must keep abreast of the change, and we must produce new products.

The present excess-profits-tax law works an extreme hardship on our company because the provisions of section 443, which are intended apparently to provide relief in the case of abnormalities of the base period, just do not fit the chemical industry.

Practically every successful chemical company manufactures a large number of products. My small company manufactures 10. Many of my larger competitors manufacture several hundred. To introduce a new product and bring it to profitable operation takes, in the chemical industry, a great deal longer than the 3 years mentioned in the tax bill, and it is entirely impossible—I feel I can say as much as that—it is impossible for a chemical company bringing in a new product, when they generally have a hard time during the first few years, to bring them to a point where any one or any small group that they brought in of these new products, could possibly produce even approaching 40 percent of the gross income of the company or 33 percent of the net income.

I am sending to Mr. Stam and Mr. Kirby, your advisers, quotations from periodical literature, which are too long to present to you here, but which I have referred to in the written testimony. They are not written in there but simply are quotations from well-known people, pointing out these two important facts in chemistry.

(1) That it takes much more than 3 years—the average is probably around 7 years—to bring a new product to fruition.

The well-known writer, Mr. William S. Haynes, says in his book on chemicals called The Chemical Front, that—

> The development of a new product rarely takes less than 5 years, and often as long as 15 years.

Senator BYRD. I am sorry to interrupt you, but you have exceeded your 10 minutes.

Mr. EUSTIS. May I show you this? I did not realize that time had gone so fast. It is a graph showing the experience of our company during the base period, which is the measure.

These first four columns represent the 4 years of the base period. The top line is the earnings which our company enjoyed from the sale of its older and well-established products. During that time we brought out one new product, namely, aerosol insecticides.

As is not unusual, during its early years, that product showed a loss, and reduced our income which we can use as a base in measuring our proper procedure down to here.

This column is the average of the three best years, as provided in the law. The average loss there reduced our income that we really made from our regular products by this amount, and the net result is that we are currently paying $52,000 a year in additional taxes because of that loss during the base period.

I find it very hard to believe that the Government thinks it is right to place a tax on losses.

Senator BYRD. Thank you very much, Mr. Eustis.

Mr. EUSTIS. In closing may I say to you gentlemen that I am a great admirer of your committee. Frankly, you gentlemen are my principal hope for the future of this country. I am an old-timer, and I do not like too much the way things are going. I know you will give consideration to these abnormalities and hardships that I point out. I do thank you for giving me the chance to speak to you.

Senator BYRD. Thank you, Mr. Eustis. We will give your statement full consideration.

(The prepared statement of Frederic Eustis follows:)

STATEMENT OF FREDERIC A. EUSTIS

My name is Frederic A. Eustis. I am treasurer of the Virginia Smelting Co. This company is a modest-sized manufacturer of chemical specialties. Its headquarters are at West Norfolk, Va., and it has approximately 350 employees.

This company has grown slowly but steadily for 35 years. Its competitors are mostly much larger than it is. I am deeply concerned over the impact of mounting tax rates on its future history. I am also concerned over the discriminatory way in which these high rates operate because of the failure to provide individualized standards of normality under the excess-profits tax.

My company has to grow to be able to continue to compete successfully with its bigger competitors. It has always used a large part of its earnings to keep its plant up to date, to increase its production, and to produce new products. When it has to give up 62 percent of its earnings for Federal taxes alone—and there are State and local taxes also—it is seriously threatened in its ability to continue to grow and prosper.

I know that my company is not alone in this predicament. Four of my business acquaintances who operate modest-sized chemical manufacturing companies tell me that they are in a similar position and they have each individually asked me to express to your committee their serious concern over the tax burden being put upon them by the Federal Government. These companies are: R. J. King Co., Inc., Norwalk, Conn.; Lotte Chemical & Dye Co., Paterson, N. J.; Magnus Chemical Co., Garwood, N. J.; Purocaine, Inc., Hockessin, Del.

We are a small group in the Nation, but I submit to you in the most earnest way possible that the welfare of this country depends very largely on the vast number of smaller concerns who are growing up.

If by taxation and other burdens the Government handicaps much more the small growing companies, more and more of our manufacturing and distributing activities will be handed over to the few very large corporations. Too much concentration of power and wealth in the hands of a few very large companies does not augur well for the future of our country.

I realize fully the difficult position in which our country finds itself. I realize the serious threat of communism and I want to do my full share to help our Nation in this emergency. I realize that our country has to raise each year a very large amount of money to enable our Government to build up the defenses we need.

My appeal to you is that you do not push the tax burden on income to the point where the small growing companies will stop growing.

I urge you, as Senators, to curb nondefense expenditures as much as possible and to distribute the tax burden needed to raise the funds absolutely required in such a manner as will give the small growing companies a chance to keep on growing.

There are other means of increasing the Federal income besides taxes on income of corporations and individuals. Excise taxes are less burdensome on small growing companies.

I admire your committee and the men on it. You are, to me, one of the chief sources of hope for the continued growth of our country. I know you will face courageously this terribly serious tax problem and take action that will safeguard the continuance of growth of our Nation's industry, even if that action be not too popular. Our Nation today needs men of foresight and courage.

Congress' concern over the growth problem of small business is evident from the effort made in the Excess Profits Tax Act of 1950 to protect small business, especially through devices intended to reflect growth in the determination of the excess-profits credit. Two things must not be lost sight of, however.

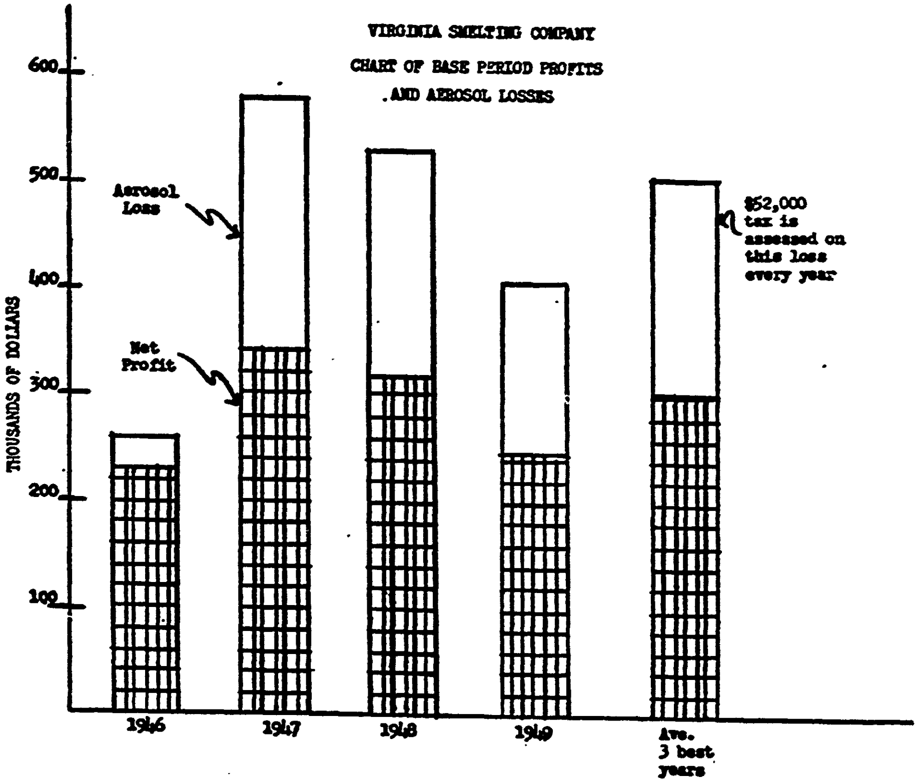
One is that no set of relief provisions will ever be completely adequate, which means that a large number of taxpayers will be forced to look to the ceiling provision to keep from being taxed out of business. The second is that the excess profits credit has been set so low with reference to current earnings standards that, even where there are no base period abnormalities or where the present relief provisions are adequate for their correction, the maximum rates are likely to be pretty generally effective, leaving out of account, of course, the $25,000 minimum excess profits credit. Though not completely, it is in large part, true, therefore that, disguised as an excess-profits tax, what we have really had is a 15-percentage-point rise in the corporate income tax for progressive companies. Under the House bill, with the further drop it proposes in the average earnings credit, this situation would become even more pronounced.

The maximum wartime corporate rate, after postwar credit, was between 72 and 73 percent. But this rate did not operate until the taxpayer's income was from 3⅓ to 5 times its credit, depending on the year, whereas now the ceiling rate cuts in at twice the taxpayer's credit. Moreover, the point of departure in World War II was the 40 percent normal and surtax rate, whereas now it is a 47 percent normal and surtax rate, proposed to be raised to 52 percent by the House bill. The net result is a higher over-all effective rate in most instances than prevailed in World War II. Regardless of what is done with the normal and surtax rates, to raise the ceiling under these circumstances is to push corporate tax rates beyond what business, particularly small business, ought to have to bear. In fact, even the 62 percent current rate is obviously too high when, as shown above, it is so universally applicable as to become in effect the regular corporate rate.

Only if we realize that for live companies the regular corporate rate is really now 62 percent and that the House bill proposes to raise it to 70 percent, and stop deluding ourselves with talk of 47 and 52 percent rates, supplemented by some sort of excess profits tax, will we fully appreciate what a terrific burden the corporate tax load is.

The virtual conversion of the ceiling rate into the ordinary rate is largely the result of an inadequate excess profits credit structure. The most glaring defect is the use of only 85 percent (with a reduction to 75 percent proposed in the House bill) of average base period net income as the point beyond which profits are regarded as excessive. But of almost equal importance to my company is the failure to make adequate provision for base period abnormalities. During the base period Virginia Smelting Co.'s earnings were reduced by about one-third as a result of developmental losses incident to the introduction of a new product. Because of the rigid requirements of section 443—which are unrealistic when applied to the chemical industry—new product relief is unavailable. Therefore, and since the product in question is now an income-producer, not only is every penny made on that product treated as excess profits, but 85 percent of the base period loss is also currently treated as excess profits every year the excess-profits tax is in effect. The latter factor increases our tax by $52,000 per year (see attached graph). The situation in which we find ourselves and suggested solutions are discussed in a memorandum, attached, prepared by our counsel.

As will be seen, section 443 fails to take cognizance of two facts important in the chemical manufacturing industry. In the first place, based on the assumption that a normal earnings level for a new product will be attained within 3 years of introduction, it excludes new products introduced more than 3 years prior to the close of the base period. I am sending to Mr. Stam and to Mr. Kriby three sheets, each quoting well-known books or periodicals giving the opinions of different authors on the time required to bring a new chemical product to profitable manufacture. These show that the general experience is about 7 years. The well-known writer on chemicals, Mr. Williams Haynes, says in his book the Chemical Front: "The development of a new product rarely takes less than 5 years and often as long as 15 years".


VIRGINIA SMELTING COMPANY
CHART OF BASE PERIOD PROFITS
AND AEROSOL LOSSES
THOUSANDS OF DOLLARS
600
500
400
300
200
100
Aerosol Loss
Net Profit
$52,000 tax is assessed on this loss every year
1946
1947
1948
1949
Ave. 3 best years

Secondly, section 443 is unrealistic from the standpoint of the chemical industry in requiring that more than 40 percent of the taxpayer's gross income or 33 percent of its net income must be attributable to the new product within 3 years of its introduction. Chemical manufacturers generaly each produce a large number of products. The number of new products produced per year by each company is relatively small, the average for 100 leading chemical manufacturers being 2¾₀ percent of the number of old products. I am sending to Mr. Stam and to Mr. Kirby a sheet giving data from which these average figures are derived. This being the situation, it is almost impossible for a chemical company to meet the requirements of section 443, since virtually never will one new product or group of new products introduced within the span of 3 years produce the proportional change required by the section. I seriously doubt whether Congress intended to rule out an entire industry, particularly one as dynamic as the chemical industry.

Excess-Profits Tax Relief—New Product Losses in Base Period

I. GENERAL

This memorandum is written on behalf of the Virginia Smelting Co., West Norfolk, Va., and deals with an important new product type of case which is not covered by section 443 or any other relief provision of the new Excess Profits Tax Act. Briefly stated, this type of case is one where the new product has produced substantial losses throughout the base period, thereby materially distorting the taxpayer's base-period experience, but where it does not qualify the taxpayer for the affirmative type of relief provided by section 443, either because the 3-year test period is too short, or because the taxpayer manufacturers too many other products for one new one to produce the required relative effect on earnings, or for other reasons. Under the law as it stands, the taxpayer is at a double disadvantage: Not only is it denied the right to have its excess-profits credit reflect a normal earnings level [1] for the new product, but its excess-profits credit will actually be reduced because of the base-period losses of the product.

II. THE TAXPAYER'S FACTS

Following the close of the war and as part of a program of expansion, Virginia Smelting embarked upon the introduction of a new product, aerosol insecticides for industrial use. The venture was a large one. Almost $200,000 was invested in the construction of a plant, placed in operation in 1947, for the manufacture of this new product. Large amounts of working capital were also dedicated to the new venture. Raw materials and containers were assembled and a new organization to market the product was created. There can be no question of the substantiality of the change in the taxpayer's normal operations represented by its entrance into the aerosol field.

The aerosol operation was "in the red" throughout the entire base period. The relative size of the losses from this source and their depressing effect upon income from other sources are shown by the following schedule:

Year	Net income before aerosol loss	Aerosol loss	Net income after aerosol loss
1946	$260,200	$31,800	$228,400
1947	579,900	235,800	340,100
1948	534,000	216,200	317,800
1949	408,300	159,400	248,900

These calculations have been conservatively made, in that allocation of indirect expenses is made on a percentage-of-sale basis, whereas a much higher allocation based on time would have been wholly justified.

Low profitability, and even losses, during the initial period of introduction were not unexpected. Such experience is usual. But losses of the magnitude actually suffered were not anticipated. Because of faulty nozzle design, much of the application equipment had to be discarded. Taxpayers' principal customer did not purchase the quantities expected. New outlets had therefore to be developed. The overcoming of these development difficulties was slow, laborious,

[1] Though this is sec. 722 language, we assume the industry-ratio approach did not intend to alter the concepts, but merely the mechanics, of relief.

and costly. By the end of the base period, however, the battle had been largely won and it was plain that the aerosol operation was about to go from red to black. But this "getting over the hump" will be largely illusory if, by leaving the base period unadjusted, the Excess Profits Tax Act in effect levies a 30-percent tax on the aerosol losses in perpetuity.

III. HOW TO PROVIDE RELIEF

There is unquestionably a gap in the statute. Two methods are available to fill this gap. One is to amend section 443 so as to eliminate its restriction of eligible changes to those taking place in the last 36 months of the base period and to include costs and expenses as an alternate substantiality test. The other is to forego the plus type of relief afforded by section 443 and to provide merely for the elimination of base period losses, if any, in new product cases which do not measure up to the standards of section 443 as presently drawn. By coincidence, either form of relief would produce about the same credit in taxpayer's case, which indicates that taxpayer is above the industry average rate of return in its established business. The probability that, given time, the company would attain equal profitability on its new venture thus becomes a virtual certainty.

A. Amendment of section 443

Two things are wrong with the present section 443. The first is the 3-year limitation on eligible changes, which appears to be an outgrowth of the old 2-year push-back provision. It is well known, however, that as much as 10 years are often required in the chemical field to bring a new product up to the earnings level of older and more established ones. The need for a precise cut-off date is not so great when the reconstruction is not individualized, as it was under section 722, but generalized, as it is under the industry approach of section 443. It is necessary only to be certain that enough time has not elapsed for fully realizing the potentialities of the change. Three years is too short a period to serve as a rule of thumb for this purpose. Five or six years would be much better geared to the realities of industrial life. This defect could be cured by amending section 443 (a) (1) to read as follows:

"(1) During so much of its five immediately preceding taxable years as falls within the sixty-month period ending on the last day of its base period, there was a substantial change in the products or services furnished by the taxpayer, and either."

The second thing wrong with section 443 is that its substantiality tests are entirely in terms of income. At first blush it may appear that, if the relief provided by section 443 represents an addition to income on account of new products, a substantiality test in terms of income is appropriate. But, on further reflection, the logical necessity of such an approach is less apparent. A fundamental change in the new relief provisions over section 722 is the basic assumption that the use of industry rates of return will produce the required normal earnings level. Under such a philosophy, we think that materiality might as appropriately be tested by large relative losses as by large relative additions to income. Neither the new corporation nor the increased capacity-relief provisions require taxpayer-specific proof of profitability. Moreover, in the increased capacity section, where, as in new product cases, proof of substantiality is required, the magnitude of the change is expressed in terms of percentage of capacity increase or capital expenditure, not gross or net income. The corresponding approach for section 443 purposes would be to test materiality by the ratio of new-product losses to net income; in other words, if new-product losses have reduced the net income from other sources substantially, the section would be deemed to apply. This could be accomplished by adding as an alternative test to the tests now specified in section 443 (a) (2) and (3) one expressed as follows:

"(4) Its average monthly excess profits net income for the base period (determined under subsection (e) and without reference to the gross receipts, cost of goods sold, and deductions attributable to the new products or services) is at least 125 per centum of the taxpayer's average monthly excess profits net income for the base period (determined under subsection (e) after taking such gross receipts, cost of goods sold, and deductions into account),".

B. Amendment of section 433 (b) (9) and (10)

An alternative to the section 443 approach is, as already indicated, the abnormal deduction approach. This could take the form of amending section 433 (b) (9) and (10) to make certain that new product losses are regarded as a single deduction and that adjustment is not prohibited by the change in the character of the business test. To accomplish this it is necessary only to add after paragraph (9) (C) a new subparagraph (D), reading as follows:

"(D) A net loss attributable to new products or services introduced by the taxpayer in the sixty-month period ending on the last day of its base period.", and insert at the beginning of paragraph (10) (C) the following:

"Except for deductions described in paragraph (9) (D),".

C. Rudolf Peterson,
Counsel for Virginia Smelting Co.

July 24, 1951.

Senator Byrd. The next witness is Mr. C. H. Baldwin.

Mr. Eustis. May I show this? It is reproduced in a smaller way, but it stands out better that way.

Senator Byrd. Mr. Baldwin, will you identify yourself to the stenographer, please, sir?

STATEMENT OF C. H. BALDWIN, LANSING, MICH.

Mr. Baldwin. Mr. Chairman, and gentlemen of the committee. my name is C. H. Baldwin of Lansing, Mich.

I would like to speak to you not to exceed 3 minutes on the family partnership.

Senator Byrd. All right, sir.

Mr. Baldwin. I would like to speak in the second person, please. There are just a few of us here.

Assuming that you men were the heads of families and you had a boy reaching his majority, and also had two daughters, and your son wanted to go into business with you, you would feel flattered. I did.

We made the arrangement, went to our attorneys, and they looked over the situation—this was in 1941—and suggested that we form a family partnership, which was absolutely legal, and not running afoul of any State laws or Federal laws at that time.

We operated as such, went on for several years, made approximately $2 million, and the Federal Government has taken every cent that I have and has levied a deficit of $244,510 against me.

I have not a cent in the world. If we would have made $5 million, we would have had a deficit of $600,000 against us. We cannot understand it.

I do not think it is the intent of this committee to allow that sort of thing to go on. I have nothing more to say. I think every one of you has a copy of this in your files.

Senator Byrd. Thank you, Mr. Baldwin.

Mr. Stam, will you make a note to prepare a memo on this case?

Mr. Baldwin. I have an extra copy, after which I am all through.

Senator Byrd. Does Mr. Stam have your figures?

Mr. Baldwin. We have a 90-day notice now that Mr. Stam does not have. I have to have that.

Senator Byrd. I think that would be worth while to get a special memorandum of from Mr. Stam.

Mr. Baldwin. You have a copy of this, Mr. Stam.

Senator Byrd. We will certainly go into it very fully, Mr. Baldwin.

Mr. Baldwin. I thank you a lot.

Senator Byrd. The next witness is Mr. Frank S. Boice.

STATEMENT OF FRANK S. BOICE, CHAIRMAN, NATIONAL LIVESTOCK TAX COMMITTEE, SONOITA, ARIZ.

Mr. BOICE. Mr. Chairman, I anticipate that there will be legal questions asked, and I would like to have our attorney sit here with me. He is Mr. Stephen Hart.

Senator BYRD. Will you identify yourself, please.

Senator MILLIKIN. Mr. Hart is a very fine lawyer and citizen of Colorado, and I commend him to the attention of this committee.

Mr. BOICE. My name is Frank S. Boice, and I am a cattleman from Sonoita, Ariz.——

Senator BYRD. You have been assigned 10 minutes.

Mr. BOICE. And make this statement as chairman of the National Live Stock Tax Committee, representing the American National Cattlemen's Association, the National Wool Growers Association, the three National Beef Breed Associations, namely, Hereford, Aberdeen Angus, and Shorthorn and some 33 State cattle and wool growers associations covering the bulk of the western and southern cattle and sheep producing States.

We are intensely interested in section 306 of H. R. 4473 concerning sales of livestock held for draft, breeding, or dairy purposes. This question has deteriorated into a fight between the Bureau of Internal Revenue on the one hand and Congress, the courts, and the taxpayers on the other.

We, as taxpayers, are asking for nothing more than the courts and all expressions of Congress to date have said we should have. The Bureau persists in refusing to recognize the requests of Congress and the decisions of the courts.

Section 117 (j) of the present code applies to "property used in the trade or business." Treasury rulings issued in 1944 and 1945 (I. T. 3666 and I. T. 3712) rightly held that such term includes livestock held for draft, breeding, or dairy purposes but attempted to exclude from such term normal sales of old animals sometimes referred to as "culls." Such limitation was held invalid by the Eighth Circuit Court of Appeals in the Albright case (173 F. (2d) 399), and numerous Tax Court and district court decisions. (2) *Emerson* (12 T. C. 875), *Oberg* (1949 Memo T. C.), *Fawn Lake Ranch* (12 T. C. 1139), *Fritz* (1950 Memo T. C.), *Flato* (14 T. C. 1250), *Mitchell* (U. S. District Court Northern District California), *Retz* (U. S. District Court Northern District Iowa), *Millef* (U. S. District Northern District Nebraska), and many others.

The conference committee on the Revenue Act of 1950 requested the Bureau to follow the Albright decision, but the Treasury refused to do so, and continued its litigation with uniform lack of success. Finally, after the Fifth Circuit Court of Appeals in the *Bennett case* (186 F. (2d) 407) reached the same conclusion as the eighth circuit in the Albright case and after the introduction of bills in the House to force acquiescence, the Bureau in April 1951 announced that it would recognize capital gains on these "culls." Shifting its ground, however, simultaneously it announced its decision to deny capital gains on younger animals, those "not used for substantially their full period of usefullness." Such policy has been implemented by a new ruling, mimeograph 6660 released subsequently to the passage of the House bill.

I would like to add that our reports from the field, that is, reports from taxpayers, indicate that the revenue agents are interpreting this mimeograph to mean that only animals that have completely outlived their usefulness will be allowed to qualify for capital gains treatment. We have that report.

Senator MILLIKIN. That presents a complete reversal on the part of the Bureau.

Mr. BOICE. That is rather complete.

Senator MILLIKIN. When they adhere to what they should have adhered to from the beginning, to wit, the court decisions, then they put in the hook by reversing themselves on the younger animals.

Mr. BOICE. That is right.

Senator MILLIKIN. Is that right?

Mr. BOICE. And apparently the revenue agents are interpreting it to mean that only animals that have completely outlived their usefulness will be qualified for capital sales treatment.

Such denial of capital gains on prime and young animals used for draft, breeding or dairy purposes is contrary to earlier rulings of the Bureau and at least eight Tax Court, district court and court of appeals decisions and it discriminates against livestock, for no such principle applies with respect to other types of business property.

It has compounded the confusion. Hundreds of thousands of farmers are in a turmoil over disputed returns and claims for refund and in ignorance as to what to do. If such Bureau policy is permitted to stand, the litigation and conflict will continue, perhaps for years.

The larger operators can take care of themselves. They will hire adequate counsel and fight this thing. It is the smaller operator, the ones who cannot afford to hire competent counsel, who will suffer under such a condition of affairs.

We favored the addition of section 306 to the House bill. In view of the unreasonable limitations, however, contained in the subsequent ruling we feel that the language of the House bill should be elaborated by the Senate so as specifically to negative these invalid limitations and to anticipate other threatened retaliatory interpretations—so as to say to the Treasury, "This means you."

Senator MILLIKIN. Have they threatened retaliatory measures or is that something which you fear?

Mr. BOICE. Yes. It was in their press release issued by them about a month or 6 weeks ago.

Senator MILLIKIN. What was the guts of that?

Mr. BOICE. They were going to reconsider the rulings related to this problem. We understand they have in mind those governing inventories and cash-basis method of accounting for livestock people, and that is the threat.

We feel that the bill should be amended to specify that it applies to livestock used for draft, breeding or dairy purposes, whether old or young, and that the holding period starts with the date of acquisition, not the date the animal is put to use.

We feel that it should state that it is retroactive except in the extension of the holding period from 6 to 12 months. We would like the committee report to refer to these decisions and to spell out the fact that the amendment confirms present accounting methods for computing gain. We are not asking that animals held primarily for sale be treated as capital assets, but we are asking that the Treasury fairly and sincerely allow capital gain on these held for draft, breeding or dairy purposes. In order to reinforce this distinction, we are willing to accept the increase in the holding period to 12 months. If so amended we feel that the bill would merely be stating more clearly what the House bill already intends.

Accordingly, we request that the bill be amended to read as follows:

SEC. 306. SALES OF LIVESTOCK.

Section 117 (j) (1) is hereby amended by adding at the end thereof the following new sentence: "Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition." The amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from six to twelve months shall be applicable to taxable years beginning after December 31, 1950.

We would also like permission to consult with your technical advisors with respect to the language in the report.

We appreciate very much, Mr. Chairman, the opportunity to appear before you, and will be happy to answer any questions which occur.

Thank you.

Senator BYRD. Thank you very much.

Senator MILLIKIN. Mr. Chairman, they do not need any permission to talk to the staff, but I hope they do talk to the staff, and I hope that the staff will be prepared to talk with us about it when we come to the executive session.

Senator BYRD. Thank you very much, sir.

Mr. BOICE. Thank you.

Senator BYRD. The next witness is Mr. T. P. Tonne, of Chicago. Mr. Tonne, will you please be seated.

STATEMENT OF T. P. TONNE, ASSISTANT TREASURER, NATIONAL CITY LINES, INC.

Mr. TONNE. My name is Theodore P. Tonne. I am assistant treasurer of National City Lines, Inc., Chicago, Ill.

Senator BYRD. Proceed.

Mr. TONNE. I was not aware when I became concerned about the provisions of section 123 that there were so many other people interested in it. Therefore, what I am going to read to you may be redundant.

Section 123 of H. R. 4473 would amend the Internal Revenue Code to provide a "limitation on surtax exemption in the case of related corporations."

If enacted into the code this amendment would inflict an unfair tax burden on a related group of corporations such as National City Lines, Inc., and subsidiaries, which I represent. It would be applied where tax avoidance has not been attempted; where tax avoidance by split-ups would be impossible.

Section 123 denies the use of all but one of the $25,000 surtax exemptions which would otherwise be allowable to a group of affiliated corporations. Ownership of 95 percent of the stock of one or more of a group of corporations, by a member of that group, automatically brings section 123 into effect. No exceptions are provided for cases where inequity would result.

Through the holding of the entire outstanding capital stock of each of 43 operating companies, National City Lines, Inc. owns the local bus-transportation systems in 43 cities in 14 States of the United States. The communities served range in population from about 43,000 to 343,000. This arrangement has been in effect for over 16 years and was dictated by legal and practical requirements of the business without reference to any tax-avoidance scheme. Some States require a company operating a local transit system to be a domestic corporation of that State. Each of the companies in the normal course of operations must make frequent appearances before State or local governmental bodies in connection with service and rates of fare.

In connection with these appearances a great deal of financial and other information must be submitted pertaining to the individual operating companies. If several units were each operated as a division of one company, the latter would not only have to submit figures for each of its operations when any one operation was appearing before a governmental body but it would also have to prove the propriety of the allocation of every item of income and expense as between the operating divisions.

The cost of this additional work would often be prohibitive. Each operating company now has its own union contract. If the companies were combined, varying local conditions such as prevailing wage rates, working conditions, cost of living, and so forth, would place serious obstacles in the way of satisfactory negotiation of future union contracts. Everything considered, National City Lines, Inc., can only function through the use of a separate corporation for each city in which it operates.

Each operating company is regulated by a State or local governmental body which, through determining the rates of fares to be charged, fixes the income which the company may earn. Such earnings are after all charges including Federal income taxes. As the regulatory authorities treat each operation as an independent unit, the effect of section 123 would certainly be ignored by them in any future computation, since it would only apply when they are affiliated companies.

The end result would be that the increase in surtax would result in reducing the amount of allowable profit, which allowable profit is, in other respects, after Federal income tax.

The ownership of numerous small- and medium-sized operations in one holding company is very desirable, as it allows a centralization of such functions as supervision, management, purchasing, public and employee relations, safety, accounting and finance. This results in a much higher degree of efficiency and economy than could be obtained or afforded if each company were independently owned and operated. We just could not give the service that we can, having a much larger field.

I wish to point out that the savings resulting from such common ownership are passed on to the riding public in the communities served.

And from the viewpoint of National City Lines, Inc., the State or local regulatory bodies are required by law to fix the earnings of the operating companies at a level which will attract and hold capital in the public transit business.

As section 123 would be ignored by regulatory bodies, it would reduce the annual profits of each company about $5,000, below the point where investment is attractive to capital. It would not prevent tax avoidance because no tax avoidance has been attempted. It would simply place a penalty on an arrangement which, by grouping, gives the advantages of size to many small transportation companies. By reducing the combined earnings by approximately $225,000, a year below the fair return level, section 123 would tend to destroy the progress of the past and far future improvement.

The possible effectiveness of section 123 as a bar to tax avoidance appears doubtful. It seems to me that if a split-up for tax purposes were planned a tax expert would not have much trouble in devising a scheme outside the terms of section 123. The introduction of a 6 percent minority interest might work. There must be other possibilities. I am no expert but it seems to me the section would be most effective against the innocent.

I have tried to show that section 123 would impose a severe penalty on our business which is organized in a manner that has been good for the people that own the business and good for the people they serve. From the standpoint of our riders, they should not be denied the benefits arising from the grouping of several small operations into an economical unit. From the standpoint of National City Lines, it should not be subjected to a substantial tax which would be treated by State commissions in a way different from other taxes merely because National City Lines, Inc., operates in 43 small cities instead of in one big city.

If the section is needed to plug a loophole, its application should be designed for and limited to instances where corporations are grouped without business purpose other than tax avoidance, or else exception should be provided for related corporations where the operating companies are subject to public regulation.

I wish to thank you for granting me this opportunity to appear before you gentlemen.

Senator BYRD. Thank you, Mr. Tonne.

Mr. TONNE. Thank you, sir.

Senator BYRD. The next witness is Mr. J. Stanley Halperin.

STATEMENT OF J. STANLEY HALPERIN, WOMEN'S APPAREL CHAINS ASSOCIATION, INC.

Mr. HALPERIN. Senator Byrd, copies of my statement have been filed with the clerk of the committee, and I would like to have the formal statement inserted in the record.

Senator BYRD. Yes.

Identify yourself, please, sir.

Mr. HALPERIN. My name is J. Stanley Halperin, an attorney, of 46 Cedar Street, New York (5), N. Y.

I appear on behalf of the Women's Apparel Chains Association, Inc., of New York City.

I wish to point out that the time of Samuel D. May and Mr. Julius Altman have been consolidated with my own time, and I am including their statements in mine.

Senator BYRD. That does not make it possible for you to take more than 10 minutes, does it?

Mr. HALPERIN. No, it does not. I will do my best to keep it within the limitation.

The members of our association are engaged in the sale at retail of popular-priced women's apparel through over 1,100 stores located throughout the country. Each of the members is the operator of a number of retail stores and outlets, many of which are operated as separate corporations.

In many cases such subsidiary corporations are owned 100 percent by the parent corporation. In other cases, however, the stock ownership percentage is less than 95 percent.

In the great majority of cases, the net profit of each store, before taxes, is substantially below $25,000.

Our position respecting section 123 of H. R. 4473, as to which I appear in opposition, is respectfully set forth hereinafter.

The first point I would like to make is that a distinction should be made between multiple corporation structures which are bona fide, and those which are artificial.

As presently worded, the provisions of the bill, as passed by the House, make no distinction whatsoever between a multiple corporation structure which is bona fide and which is not a tax-avoidance scheme, and one which is the result of the artificial splitting-up of the enterprise.

It applies equally to the new multiple corporation structure, and the one which has been in existence for 20 years and upward.

It is difficult to reconcile this House proposal, which confessedly was adopted on the recommendation of the Treasury Department, with the two basic fundamentals of policy which have always been followed in tax legislation, and especially by this committee, namely, firstly, the bona fide conduct of business in the ordinary way shall not be impeded; and secondly, retroactivity, especially where the practice has been known to and approved by the Treasury Department, is to be avoided and the corrective provision shall be made prospective only, in its operation.

I will not take the time of this committee to discuss the many business reasons which justify the method of operation known as the multiple corporation structure. That has been discussed many times by other witnesses.

I also would like to point out that the Treasury Department over the years has admitted that the multiple corporation structure represents the bona fide conduct of business in the ordinary way. In this respect, Senators, we have had a number of our members who have gone through reorganizations having, as the end result, a multiple corporation structure whereby there is a parent corporation with each store owned and operated by a separate subsidiary corporation.

In order to arrive at that particular corporate structure, they have had to go through a tax-free reorganization under the provisions of the Internal Revenue Code. To be rules as a tax-free reorganization, it has to necessarily be found that the main purpose was not tax avoidance, but rather that there was a good underlying business purpose for the reorganization.

Without exception, in every single case in which, in our association, our members have gone through this type of reorganization, it has received the approval of the Treasury Department. As a matter of fact, in a few cases, even before any steps were undertaken to set up a multiple corporation structure to do this kind of business, the Treasury Department has issued a closing agreement before any steps were taken. In each and every case, in order to obtain such a closing agreement—and I do not mean just a ruling, I mean a closing agreement, which means going through the 30 or some-odd hands that it must go through in order to secure approval—it was necessary to establish what our business purposes were, and the very fact that we received that approval clearly indicates that the Treasury admits that this is the bona fide conduct of the business in the ordinary way.

Now if we take that as the fact, then it seems to me that the purpose of this proposal is something more than merely to stop the artificial splitting up of companies. In these particular situations, the Treasury Department, even before we took the step, stated that it was proper and issued a closing agreement to the effect that the proposed reorganization was tax-free. Under these circumstances, this particular provision would seem to be designed to do something more than merely go after the artificial split-up, because in our cases we have obtained the blessing and approval that ours were a bona fide reorganization.

That being the case, then it would seem that this provision is more designed to regulate business than to raise revenue. If we take that as the assumption, that that is what this provision is designed to do, then it would be contrary to the policy which has always guided this committee. That the policy has been to use the revenue laws only for the purpose of raising revenue and not for the purpose of reforming and changing the procedures and practices of business.

Moreover, the House provision, if its design is to treat a multiple corporation structure as a single taxpayer, does not do so. In fact, it makes the effective tax rate even higher than if a consolidated return were to be filed.

If the Treasury does concede, as we believe it must, that the multiple corporation structure is a proper method of conducting business in the ordinary way, then it is unfair to base the House provision on the fact that in certain cases there may have been an artificial split-up, and then make the House provisions applicable to all taxpayers, honest and dishonest. If that is the true purpose, then the Treasury could have requested a provision making mandatory the filing of consolidated returns, which it never did.

I would also like to point out to the committee that I do not believe that the Ways and Means Committee ever intended that this provision should apply to anything other than an artificial split-up.

Whichever way you examine the House provision, you must reach that particular conclusion. A reading and a rereading of the Ways and Means Committee report discloses that the intention, at least of the Ways and Means Committee, is to make the provision applicable only to the artificial split-up.

The summary which is set forth in table 12 of page 62 of the report describes section 123 as—

> Closing of loopholes concerned with * * * (b) Corporate split-ups to obtain multiple exemptions and credits.

Your attention is directed to the descriptive language "to obtain" which clearly evidences an intention to make section 123 applicable only to the artificial set-up or split-up.

Furthermore, I would like to point out that there is no justification for making the House provision applicable to existing bona fide multiple corporation structures. The Treasury has been aware of this method of operation for many years.

It was at the Treasury's request that section 129 of the Internal Revenue Code, which is and was designed to deny to the artificial split-up any tax advantage which might accrue, was enacted in the Revenue Act of 1943.

At that time, too, the House proposal was so broad in its language as to include those bona fide taxpayers who were not intended to be included within its scope.

This committee, the Senate Finance Committee, delimited the language so as to effectuate the true purpose, namely, to deny the beneficial provisions of the tax laws to the artificer, the tax dodger.

Moreover, the original House provision in the 1943 bill made section 129 retroactive to all years beginning after December 31, 1939. The Senate refused to give it retroactive effect, making it applicable only to years beginning after December 31, 1943. In so doing (which amendment was agreed to by the House), the Senate compelled both the taxpayer and the Government to rely upon the then existing laws for past years.

This would be the fair thing to do with the present section 123. If a split-up was a tax-avoidance scheme, the existing sections 45 and 129 are sufficiently strong to upset it.

It is impossible to explain why, in 1951, it is justifiable to deny the status of separate entities to multiple corporation structures which, for example, have had such a structure since they came out of insolvency proceedings in 1932, whereas, in 1943, when we were at war, it was not considered justifiable to do so to the very same multiple corporation structure.

Even the House, in proposing section 129 of the 1943 act, made it applicable only to transactions, split-ups, occurring on and after October 8, 1940, yet this new provision in the 1951 bill could and would apply to transactions which occurred long before that time.

Thus, we have a situation where the Treasury has requested implementation of section 129, implementation sufficient to give it the broad coverage it sought in 1943, and which the Senate then denied.

The Treasury desires such implementation to be retroactive, not merely to the date specified in the existing section 129, namely, October 8, 1940, but rather to the very beginning of time, and the House provision has granted the Treasury's requests.

Multiple corporation structures which antedated October 8, 1940, whether or not spawned in tax-avoidance, were exempted from the operation of section 129 as added by the 1943 act despite the recognized tax advantage they would enjoy by reason of such exemption.

The new section 123, which would now apply to such taxpayers, does not even give to them the same privileges which they would have had under section 129, namely, the right to prove that the multiple corporation structure was not adopted because of the tax-avoidance motive. In truth, even if such right were granted, it would be difficult at this late date, if not impossible in many cases, to present adequate proof because of the death of witnesses, destruction of records, and so forth.

It seems more logical to assume that the provision should have contained some cut-off date, prior to which time multiple corporation structures would be vulnerable only under existing law as at that time, and after that date, vulnerable to the new provision as well.

We believe, therefore, that a distinction could and should be made between a bona fide and artificial split-up, and that a bona fide split-up, regardless of when consummated, whether before or after the enactment of the Revenue Act of 1943, should result in the same tax treatment as is presently accorded to a split-up which may have occurred, for example, in 1932.

It is our position that existing law does give the Treasury adequate remedies and safeguards against a split-up which is nothing more than a tax-avoidance scheme. If it is ultimately determined that additional safeguards are necessary, they should then be enacted.

However, they should be made prospective in their application, applying only to transactions occurring after a date upon which the tax-paying public could be said to have been put on notice of the intended change in the law.

In the case of section 123, this date would be May 3, 1951, the first time that the proposal was mentioned in the Congressional Record.

I do not believe that section 123 as passed by the House, should remain in the bill, but rather, should be entirely eliminated.

I should like——

Senator BYRD. I am sorry to interrupt you, but your time has expired. We have two other witnesses to hear before we recess at 12 o'clock.

Mr. HALPERIN. I was going to spend just about another 3 or 5 minutes, Senator Byrd, if I can have your indulgence. I will not read all of it, I promise you.

Senator BYRD. You can insert it in the record.

(Discussion was continued off the record.)

Senator BYRD. Your entire statement will go in the record.

Mr. HALPERIN. Thank you, sir.

(The document referred to is as follows:)

STATEMENT OF J. STANLEY HALPERIN ON BEHALF OF WOMEN'S APPAREL CHAINS ASSOCIATION, INC.

Mr. Chairman and gentlemen, I am J. Stanley Halperin, an attorney, of 46 Cedar Street, New York 5, N. Y. I appear on behalf of the Women's Apparel Chains Association, Inc., 41 East Forty-second Street, New York 17, N. Y., in opposition to section 123.

The members of our association are engaged in the sale at retail of popular-priced women's apparel through over 1,100 stores located throughout the country. Each of the members is the operator of a number of retail stores and outlets, many of which are operated as separate corporations.

In many cases, such subsidiary corporations are owned 100 percent by the parent corporation. In other cases, however, the stock ownership percentage is less than 95 percent.

In the great majority of cases, the net profit of each store, before taxes, is substantially below $25,000.

Our position respecting section 123 is respectfully set forth in the following paragraphs.

POINT I. A DISTINCTION SHOULD BE MADE BETWEEN MULTIPLE CORPORATION STRUCTURES WHICH ARE BONA FIDE AND THOSE WHICH ARE ARTIFICIAL

We do not, nor could anyone raise any objection to the general purpose of the House provision—if such purpose is to prevent the artificial splitting-up of corporations solely for tax purposes. As worded, however, the provision is equally applicable to multiple-corporation structures which antedate the present excess-profits tax provisions not by just a few years, but 20 years or more and whose method of operation constitutes the bona fide conduct of business in the ordinary way.

The House provision makes no distinction between a multiple-corporation structure which is bona fide and which is not a tax avoidance scheme and the one which is the result of an artificial splitting-up of the enterprise. A multiple-corporation structure, no matter how long ago created, no matter how valid and bona fide the business reasons underlying its creation, no matter how many times examined and approved by the Bureau of Internal Revenue—is now to be classified, under the House provision in the same category as the artificial, unbusinesslike enterprise. It is not believed that it was the intention of the House proposal to label such taxpayers as "tax avoiders."

It is difficult to reconcile the House proposal, which confessedly was adopted upon the recommendation of the Treasury Department, with the two basic fundamentals of policy which have always been followed in tax legislation, namely—

(A) the bona fide conduct of business in the ordinary way shall not be impeded; and

(B) retroactivity, especially where the practice has been known to and approved by the Treasury Department, is to be avoided and the corrective provision shall be made prospective only in its operation.

(A) THE BONA FIDE CONDUCT OF BUSINESS IN THE ORDINARY WAY SHOULD NOT BE IMPEDED

Business reasons justify bona fide multiple-corporation structures

There is no doubt but that the multiple-corporation structure is the usual and ordinary method of operation in the case of retail organizations. If there were any doubt about this point before the present hearings were held, the number of trade associations and others who have and will testify on this provision should dispel any such doubt.

There are many sound business reasons why the multiple-corporation structure is the proper way of conducting a retail store organization. Previous witnesses have enumerated many of the business purposes which dictate this method of operation and, accordingly, they are not here again detailed.

Treasury Department admits multiple-corporation structure represents bona fide conduct of business in ordinary way

However, I should like to point out that the Treasury Department itself has recognized the business purposes underlying the multiple-corporation structure. In fact, more than once in recent years, it has given its blessing and approval to a corporate reorganization having as its end-result the ownership and operation of each retail unit in the organization by a separate subsidiary corporation.

If we bear in mind that for a corporate reorganization to be treated as tax-free, it must be conclusively established that the underlying purposes of the reorganization were sound business purposes and not a tax-avoidance purpose—the admission by the Treasury Department that a multiple-corporation method of conducting business is tax-free should be conclusive proof that it is not and was not a tax-avoidance scheme. Furthermore, it is conclusive proof that the multiple-corporation structure, where approved by the Treasury Department, does constitute the bona fide conduct of business in the ordinary way.

We do not know how many rulings and closing agreements have been issued in toto, approving reorganizations which resulted in multiple corporation structures. For the members of our association, however, every member which went through some revamping or other of its method of conducting business which resulted in a multiple corporation structure has had its returns examined by the Bureau of Internal Revenue. Without exception, the tax-free status of the transaction (and therefore, the finding that tax avoidance was not the underlying purpose) has, in each and every case, been approved. This has been the experience of our industry. We understand that this is true in others, as well.

Treasury issues closing agreement approving proposed reorganization resulting in multiple corporations

To further demonstrate the irreconcilability between what the House now proposes, based on the Treasury's recommendation and what the Treasury has been doing all these years, not only has its Bureau of Internal Revenue approved these transactions in past years upon examination of the tax returns, but also, the Secretary of the Treasury has approved the execution of closing agreements holding such multiple-corporation transactions to be tax-free.

For example, one of our members, Angerman Co., Inc., presently the owner and operator of 57 retail outlets, all of which are owned by separate subsidiary corporations, reorganized its corporate structure in 1949 to achieve this result. Before doing so, however, it made application for a closing agreement to the effect that the proposed reorganization would be tax-free. Such a closing agreement was granted and entered into and approved by the Secretary of the Treasury.

The Angerman Co. is a typical example of the multiple corporation structure. It represents a constant and steady expansion of retail outlets for more than 25 years, some of which it acquired by the purchase of outstanding stock, others of which were started by itself. In 1948, it was decided to clear up its corporate structure and to have a separate corporation own and operate each store.

Accordingly, a plan of reorganization was prepared and it was submitted to the Commissioner of Internal Revenue, requesting the issuance of a ruling and closing agreement to the effect that the proposed reorganization, when consummated, would be tax-free. The application which was filed with the Commissioner set forth the business reasons which justified the change in corporate structure. In fact, it was stated in the company's application that there might be a savings in taxes, but the company did not know if such would prove to be the case. The Commissioner issued a favorable ruling and the closing agreement was entered into.

In actual fact, however, Angerman Co. paid more in taxes than if it had not adopted the plan of reorganization. For its fiscal year ended January 31, 1950, it had 55 retail outlets. The average sales for each outlet for the year was $156,363, on which the average profit before taxes was $3,709, approximately 2.4 percent on sales. The average Federal tax liability per store was $1,563, whereas if Angerman Co. had remained as it had been before, the average Federal tax liability per store would have been $1,409, a savings of $154 per store. Does this smack of tax avoidance? Also, the average store was left with but $2,146 after taxes on an average sales volume of $156,363, approximating 1.37 percent on sales—certainly not an exorbitant profit on its volume. Is the Treasury Department now to be heard to say that the Angerman Co. reorganization was "artificial" and did not represent the bona fide conduct of business in the ordinary way?

Is House provision designed to regulate business?

Or is it to be assumed that the Treasury concedes that the multiple-corporation structure does represent the bona fide conduct of business in the ordinary way, but nevertheless, despite their respective bona fide separateness, they should be treated as one? And if such latter be the case, it would seem that this provision is more designed to regulate business than to raise revenue—a purpose and a design which is opposed to the policy invariably followed in the past by the tax-writing committees of Congress. That policy has been to use the revenue laws only for the purpose of raising revenue, and not for the purpose of reforming and changing business practices and procedures. Economic and social reform has been left to the other committees of Congress, and the tax-writing committes have always opposed the use of the revenue laws for the accomplishment of any purpose other than the raising of revenue. We agree with that policy and endorse its continuance.

Moreover, the House provision, if its design is to treat a multiple corporation structure as a single taxpayer, does not do so. In fact, it makes the effective tax rate even higher than if a consolidated return were to be filed. This is because there is no 100-percent dividends received credit allowable in the tax computation, only the 85-percent credit, leaving the remaining 15 percent subject to a double tax.

If the Treasury concedes that the multiple-corporation structure is a proper method of conducting business in the ordinary way, then it is unfair to base the House provision on the fact that in certain cases there may have been an artificial split-up and then make the House provisions applicable to all taxpayers, honest and dishonest. If that is the true purpose, then the Treasury could have requested a provision making mandatory the filing of consolidated returns, which would have accomplished such a purpose and would have laid bare on the table the full impact of this proposal. Yet this was not requested.

Ways and Means Committee intended provision only for artificial split-ups

Whichever way one examines the House provision, the conclusion is reached that what is really sought to be accomplished is the prevention of artificial split-ups in the future and the denial of any tax advantages to artificial split-ups of the past.

A reading and a re-reading of the Ways and Means Committee report discloses the intention is to make the provision applicable only to the artificial split-up. The summary set forth in table 12 on page 62 of the report describes section 123 as "Closing of loopholes concerned with— * * * (b) Corporate split-ups to obtain multiple exemptions and credits. * * *." Your attention is directed to the descriptive language "to obtain". This clearly evidences an intention to make section 123 applicable only to the artificial split-up.

At all times, however, the bona fide conduct of business in the ordinary way is not intended to be impeded.

(B) RETROACTIVITY IS NOT JUSTIFIED ON THE GROUND OF LACK OF KNOWLEDGE

There is no justification for making the House provision applicable to existing bona fide multiple-corporation structures. The Treasury has been aware of this method of operation for many years.

Senate refused to make section 129 retroactive to pre-October 8, 1940 structures

It was at the Treasury's request that section 129, which is designed to deny to the artificial split-up any tax advantages which might accrue to it, was enacted in the Revenue Act of 1943. At that time, too, the House proposal was so broad in its language as to include those bona fide taxpayers who were not intended to be included within its scope. The Senate Finance Committee delimited the language so as to effectuate the true purpose, namely, to deny the beneficial provisions of the tax laws to the artificer, the tax dodger.

Moreover, the House provision made section 129 retroactive to all years beginning after December 31, 1939. The Senate refused to give it retroactive effect, making it applicable only to years beginning after December 31, 1943. In doing so (which amendment was agreed to by the House), the Senate compelled both the taxpayer and the Government to rely upon the then existing laws for past years.

This would be the fair thing to do with the present section 123. If a split-up was a tax avoidance scheme, the existing sections 45 and 129 are sufficiently strong to upset it.

House provision would apply to pre-October 8, 1940 structures

It is impossible to explain why, in 1951, it is justifiable to deny the status of separate entities to a multiple-corporation structure which, for example, has had such a structure since it came out of insolvency proceedings in 1932 whereas in 1943, when we were at war, it was not considered justifiable to do so to the very same multiple-corporation structure. Even the House, in proposing section 129 in the 1943 act, made it applicable only to transactions occurring on and after October 8, 1940. Yet this new provision in the 1951 bill could and would apply to transactions which occurred before that time.

Thus, we have a situation where (a) the Treasury has requested implementation of section 129, implementation sufficient to give it the broad coverage it sought in 1943 and which the Senate then denied; (b) the Treasury desires such implementation to be retroactive not merely to the date specified in section 129, viz. October 8, 1940 but rather, to the beginning of time, and (c) the House provision has granted the Treasury's requests.

Multiple corporation structures which antedated October 8, 1940, whether or not spawned in tax avoidance, were exempted from the operation of section 129 despite the recognized tax advantages they would enjoy by reason of such exemption. The new section 123, which would not apply to such taxpayers, does not even give to them the same privileges which they would have had under section 129, namely, the right to prove that the multiple-corporation structure was not adopted because of the tax avoidance motive. In truth, even if such right were granted, it would be difficult at this late date, if not impossible in many cases, to present the proof because of the death of witnesses, destruction of records, etc.

No provision made for "cut-off date"

It seems more logical to assume that the provision should have contained some cut-off date, prior to which time multiple-corporation structures would be vulnerable only under existing law and after the time vulnerable to the new provision as well.

Our position

We believe that a distinction should be made between a bona fide and an artificial split-up, and that a bona fide split-up, regardless of when consummated, whether before or after the enactment of the Revenue Act of 1943, should result in the same tax treatment as is presently accorded to a split-up which may have occurred, for example, in 1932.

It is our position that existing law does give the Treasury adequate remedies and safeguards against a split-up which is nothing more than a tax avoidance scheme. If it is ultimately determined that additional safeguards are necessary, they should then be enacted. However, they should be made prospective in their application, applying only to transactions occurring after a date upon which the taxpaying public could be said to have been put on notice of the intended change in the law. In the case of section 123, this date would be May 3, 1951, the first time that the proposal was mentioned in the Congressional Record.

We do not believe that section 123 as passed by the House, should remain in the bill, but rather, should be entirely eliminated.

Point II. Section 123 Will Represent an Inordinate Increase in the Tax Burden of Those Affected by It

CONGRESS DOES NOT DISCRIMINATE

It has always been the policy of the Congress not to discriminate against a single class of taxpayer. Yet that is what section 123 will do. By reason of the denial of the surtax exemption to each of the corporations, except one in the structure, the effective tax on each one's first dollar of taxable net income will rise from the proposed normal tax of 30 to 52 percent, an increase of 74 percent over and above the increase which is proposed to be levied against all corporations. Moreover, by reason of the denial of the minimum excess-profits credit to each corporation, many a corporation will now have part of its income subject to excess-profits tax.

There is no doubt but that many such corporations will have an effective tax rate which is more than double what it would have been were it not for section 123. This has been graphically presented to you in the case of Southern Department Stores, Inc. through their representative, W. Gibson Harris, in his testimony on July 10, 1951.

BEFORE DRASTIC CHANGE, CONGRESS MAKES STUDY

It is our position that section 123 is so drastic in its concept and operation that to make its application effective at one fell swoop is contrary to congressional policy.

At no time has there ever been a 74-percent increase in the tax rate, limited to one particular class of taxpayers. There is no justification for such an increase at this time.

Point III. Section 123 Will Not Raise the $55 Million in Revenue Which Is Predicted for It

NO STUDY HAS BEEN MADE

Ordinarily, when a structural change of such impact as section 123 is proposed, it is based upon an intensive and exhaustive study made by the Treasury Department and by the staff of the joint committee. Yet no such study seems to have been made in this case. There does not appear to be any basis for the estimate of the revenue yield anticipated. To our knowledge, no industry or trade associations were requested to furnish any statistics of any kind which would aid the Treasury and the joint committee staff in this regard.

TREASURY RECOMMENDATION

So far as we have been able to ascertain, the Treasury Department recommended this provision after public hearings before the Ways and Means Committee had been closed. It is believed that the request for this provision was inspired by two recent decisions of the Tax Court of the United States, in both of which it was held that a multiple-corporation structure was bona fide and was not adopted for tax-avoidance purposes.

BASIS OF ESTIMATED REVENUE YIELD UNKNOWN

At any rate, in making the estimate, we understand that the Treasury relies on a study made by the Securities and Exchange Commission in 1947 from which it appears that there might be 16,000 corporations belonging to multiple-corporation structures. On the assumption that 50 percent filed consolidated returns, that left 8,000 corporations.

As to these 8,000 corporations, we further understand that it was assumed that the denial of a separate surtax exemption to each would mean an additional 22 percent on the first $25,000 of income, or $5,500 per corporation, or $44 million for all 8,000 corporations. Presumably the remaining $11 million to complete the estimated revenue yield is attributed to excess-profits taxes. The point is, nobody seems to know how the Treasury Department arrived at this estimate.

PREDICTED REVENUE YIELD WILL NOT MATERIALIZE

If our understanding as to what occurred is correct, then the promise that each corporation will pay an additional $5,500 in tax is fallacious, at least in our industry. Our stores are all small stores, in some cases a formerly independently owned store which has now come into the organization lock, stock, and barrel—with its former owner and manager still remaining as manager and retaining a profit-sharing interest, and all former employees continuing on. Practically all never have and still do not make $25,000 a year in profits.

We understand that other witnesses have likewise testified that the predicted revenue yield will not materialize and, in fact, for other reasons such as retarding of expansion, may result in an over-all net revenue loss.

A STUDY SHOULD FIRST BE MADE

It is our position that before so drastic a provision is approved, a more detailed study should be made in order to determine not only the necessity for and the advisability of such a provision, but what the true revenue yield might be. It is unlike the prior practice of the tax committees of the Congress to enact a provision which has not been thoroughly investigated before being proposed.

POINT IV. SECTION 123 IMPOSES TAX DISADVANTAGES WITH NO ELECTION TO ESCAPE THEM

At the risk of repetition, I should like to reiterate that the House provision, if it is designed to treat a multiple-corporation structure as a single taxpayer, does not accomplish its purpose. In fact, it makes the effective tax rate on such a group even higher than if a consolidated return were to be filed. This is because there is no 100-percent dividends-received credit allowable in the tax computation, only the 85-percent credit, leaving the remaining 15 percent subject to a double tax. The fact remains that, in many cases, a consolidated return will not be able to be filed because many multiple-corporation structures do not qualify under the consolidated returns regulations as an affiliated group entitled to filing a consolidated return. Thus, although treated as one for the tax computation, the corporations within the group would not be prmitted to offset losses of one corporation against the profits of others, would not escape the double taxation on the 15 percent of the dividends received, and would not be able to eliminate intercompany profits—all of which will result in a higher effective rate than if a consolidated return were filed, except, or course, that if it may not file a consolidated return, it has no choice. Here again the unfair discrimination of section 123 is crystal clear.

POINT V. SECTION 123 WILL SERIOUSLY INJURE OUR INDUSTRY AND THE PEOPLE WHO DEPEND ON IT

The fact that no study has ever been made as to the impact of section 123 is amply demonstrated by the injury which it will inflict on our industry and the people who depend on it for their livelihood. Other witnesses have testified as to the damages which their industries will sustain. It is clear that had all this information been available at the time the proposal was first advanced by the Treasury, section 123 would not have emerged in the form which it now has.

A TYPICAL ORGANIZATION—ITS BEGINNING

I should like to briefly describe a typical member of our industry. It usually was organized about 15 to 20 years ago, starting off as a one- or two-store operation, and in rural areas primarily. Profits were plowed back into the business and additional stores were acquired, either by the opening of new units or the purchase of existing stores. Where there was a purchase, the former owner was usually retained as manager, with a percentage interest in the profits.

Many of our members have followed the practice, since their inception, of operating each store as a separate corporation. Others have had a varied experience, depending upon whether it was a new store which the member was opening or a store the capital stock of which was being purchased. In such cases, the new store was not separately incorporated.

Ultimately, as the number of stores grew, it no longer was advisable to purchase the services of a resident-buying office in New York City and, accordingly, executive offices were opened on behalf of the group. This executive office would act as the central buying office for the entire group. The ability to buy in volume enabled the group to merchandise its inventory at a much smaller mark-up than could possibly be done if each were operating as an independently owned, completely unaffiliated store, as many of the units had previously done.

SIMPLIFICATION OF CORPORATE STRUCTURE BY ADOPTION OF MULTIPLE CORPORATIONS

During the middle 1940's, many of them, primarily those with a hodgepodge corporate structure, adopted plans of reorganization which had, as their end result, the ownership and operation of each store by a separate corporation. In every single case where this was done, the Bureau of Internal Revenue has examined the reorganization and has accepted its treatment as a nontaxable transaction, thus expressly finding that tax savings was not the motive. In a number of cases, moreover, the Treasury Department entered into closing agreements to the effect that the reorganization was tax-free.

THE DAMAGE THIS PROVISION WILL CAUSE

The incalculable damage will be caused to our industry by an effective 74-percent increase in the tax burden, if the House provision is enacted, will affect our creditors, our employees, our suppliers, and our local communities.

(a) The harm to our creditors

It goes without saying that the only source for the repayment of loans is the profit remaining after taxes. The inordinate increase proposed by section 123, in some cases will not leave sufficient profit after taxes with which to meet the annual repayment required to be made. Indications from lending institutions already indicate that loan commitments will have to be met, regardless of the proposed section 123. In such cases, if the loans cannot be refinanced, the consequences will be drastic.

Not only is this true as to such creditors as banks, insurance companies, and other lending institutions—it is also true with respect to such creditors as contractors who have made store alterations and improvements and are being repaid over a course of years.

The restriction of credit by one creditor very often sets off a chain reaction, other creditors follow suit, and, ultimately, the debtor can be thrown into an involuntary reorganization.

(b) The harm to our employees

There was a time when certain of our employees, particularly store managers and executive personnel, were paid a percentage of profits after taxes. This is not too widespread a practice although, where it still exists, section 123 will have a serious impact.

However, it is obvious that an employee's security lies in the fact that his employer is in a sound financial position. If taxes take so much away from the employer that, along with payments to be made to creditors, there is not enough left to build up a reserve to weather bad times, the employer's financial position is unsound, and it follows that the employee's position is equally unsound and insecure.

Many of the stores are marginal stores, barely breaking even on their operations. In adverse times, they are the ones which sustain the greatest losses. It is but natural that if there will not be any profits left after taxes and loan repayments, the risk of maintaining a marginal store should be eliminated, resulting in the closing of a store and the loss of jobs by six or seven employees.

(c) The harm to our suppliers

The retardation of expansion and growth of our members because of lack of capital will affect not only our trade suppliers but our contractors as well. Local contractors in small rural towns, to whom a $35,000 store alteration is a major piece of business for the entire year, can no longer look forward to this source of business. There will be not only a lack of capital, but a lack of incentive to open any new retail units.

(d) *The harm to the local community*

We believe that the damage done to the local community will likewise be far greater than the proponents of section 123—if ever they thought about this point—calculated. Just see what happens when one of our members comes to a community. Take, for example, a store of one of our members in Bucyrus, Ohio. Bucyrus is a small rural town, which never had the benefits of big-city merchandising, styling, and low prices. Bucyrus shoppers would travel many miles to shop at department stores in the big cities, until one of our members came along.

It rented a store, which brought income to the landlord, a native of Bucyrus. The store was altered and improved, which gave employment and income to the general contractor and his many suppliers and employees. The store was staffed with local employees, thereby creating six jobs which had never before existed, and bringing additional income and purchasing power to the community. A local attorney was engaged, giving him an additional client. The local bank received a new depositor. Because of its low prices, it attracted customers from surrounding areas who never before considered Bucyrus a shopping center, and whose coming brought additional business to the other stores on Main Street.

What did it really do? It did nothing more than to come to a small town and say to a likely potential storekeeper, in effect: "You don't have the money with which to open a store. We will advance the money to you, and put you in business and give you an interest in the profits." A big business such as a large department store in nearby Cleveland doesn't come to Bucyrus. It brings nothing to the community—it only draws business away from it. On the other hand, our member brought business to the community. In effect, it has enabled someone to open his own small business.

Our members are very proud of the part they have played in bringing back to life the vacant stores on Main Street in our rural areas. The job which the big stores would not or could not do, we have done. We have gone into cities of 8,000, 9,000, and 10,000 population and have invested sums of $40,000 and more to give Main Street a store every bit as good and comparable to the big-city stores.

We should not like to be prevented from continuing this expansion, but it stands to reason that if we do not have any money left after taxes to venture into new areas, we cannot expand. We feel that we are part and parcel of the small-business movement of our country. Organizations such as our members are nothing more than a group of small businesses in competition with other small businesses in their respective communities.

POINT VI. SECTION 123 DISCRIMINATES UNFAIRLY AMONGST COMPETITORS IN THE SAME INDUSTRY

WHERE STORE MANAGERS HAVE STOCK INTEREST

As has been indicated before, at one time it was the practice in the industry to pay store managers a percentage of the profits after taxes. Very often, this was accomplished by the manager owning a percentage of the stock of the particular store he managed. Moreover, in those cases where a former owner sold his store to a multiple-corporation group, he retained a stock ownership in the corporation he was selling.

COMPETITIVE ADVANTAGES OF STRUCTURE EXEMPT FROM SECTION 123

In those cases where more than 5 percent of the stock of a store corporation is owned outside the related or affiliated group, that particular corporation is exempt from the application of section 123. Under such circumstances, it does not have to resort to higher prices in order to net the same profit after taxes, as must its next-door competitor which is subject to section 123. From the competitive point of view, it is in a position to reduce its gross profit mark-up and, because of the additional volume reduced prices will bring, still earn the same net profit after taxes.

UNFAIR COMPETITION

It is difficult for us to justify why we should be, or how we are expected to be, able to compete with a well-known organization which has approximately 300 separate corporations in the South but which sells a partial stock interest of over 5 percent in its stores to its managers. Our store managers do as well as theirs, our employees are compensated equally as well—but, now, due to the change in tax treatment, we could no longer effectively compete.

NO DIFFERENCE IN TREATMENT OF MANAGERS

We cannot stress too strongly the fact that there is no substantial difference in the treatment or compensation of a store manager in this southern group and a store manager of one of our members. In the former case, the manager's bonus comes to him as a dividend on stock. In the latter case, it comes as a percentage of the profits before taxes. In both cases, they average the same income. In both cases, they are treated the same and have the same authority within the store.

In fact, the only difference between the two is that this southern group follows the old practice of compensation by means of a percentage of profits after taxes whereas our member compensates on the basis of a percentage of profits before taxes. Yet because of this deviation in compensation, the tax position of our competitor will give it a competitive advantage which is unfair and was never intended.

We cannot believe and do not believe that it was ever intended that section 123 would have this effect. Granting relief to certain members of our industry and not to others will give rise to unfair competition, a drastic and unjustified result of a revenue-raising statute.

RECOMMENDATIONS

A. Section 123 should be deleted entirely from the bill.

B. Once it is deleted, the staff of the joint committee should be instructed to make a study of the necessity for and the advisability of and the effect of such a provision.

C. If section 123 is to be retained in some form, then—

1. It should not be retroactive, and existing laws should govern the recognition to be accorded to multiple-corporation structures existing as at a certain date.

2. For its prospective operation, a distinction should be made between a multiple-corporation structure which is such pursuant to the bona fide conduct of its business in the ordinary way and one which is a tax avoidance dodge. A bona fide multiple corporation structure, even if created after the effective date, should not be subject to the new section 123.

3. The effective date of the new section 123 should not be earlier than May 3, 1951, the date the new proposal was first announced.

4. In the case of newly organized corporations, created for bona fide reasons and which are created after May 3, 1951, then, the new section 123 should not apply if there was only made a cash investment in said new corporation, which thereafter proceeded to engage in business.

We respectfully urge you to delete section 123 until such time as a study has been made and the conclusion reached that it is necessary and advisable.

Respectfully submitted.

J. STANLEY HALPERIN.

Senator BYRD. The next witness is Mr. Cyrus B. King.

STATEMENT OF CYRUS B. KING, ATTORNEY AT LAW

Mr. KING. Mr. Chairman and members of the committee, my name is Cyrus B. King. I am a member of the State bar of California.

I reside and practice in San Francisco, Calif., limiting my practice to tax matters.

I am here representing Wixson & Crowe, Inc., of Redding, Calif.

They are general contractors, but they specialize in clearing dam reservoir sites for the Bureau of Reclamation. They have worked on some of the big dams in the country, and they are currently engaged in clearing the site for the reservoir of the Hungry Horse Dam in Montana.

I am here because there is no relief for us and similarly situated taxpayers, except from Congress.

While I am here to discuss the excess-profits-tax relief provisions, it is my sincere and considered belief that we are not asking for any new relief provision.

We simply want to call to the attention of this committee the operation of one section of the present provisions, and I want to stress that word "operation" because, I repeat, we feel that we are not seeking any relief beyond that which has already been provided by Congress, but we feel that an amendment is necessary to clarify one of the present provisions so that the intent of Congress will be carried out.

In the present Excess Profits Tax Act, the Congress has wisely omitted such general relief provisions as section 722 of the World War II act. The expense and difficulty of preparing a case to establish a right to relief under that section, and the uncertainty of the results, led to complaints from taxpayers and their advisers.

Congress has consequently, in the present law, quite wisely set up more or less automatic formulas with respect to relief provisions, but because we are confined to formulas, we think that they should be applied with equality to all taxpayers.

Our specific problem is this: Part II of the present Excess Profits Tax Act provides that when a taxpaying corporation has acquired the properties of one or more other corporations in tax-free exchanges, the taxpayer may compute its average base-period net income by taking into account the earnings history of the properties which it has taken over.

Further, even though the taxpayer itself was not in existence on January 1, 1946, which was the beginning of the base period for most corporations, it can trace its history back to that date if one or more of its components was in existence then; and if the entire financial history of the acquiring and the component corporations, taken together, meet certain requirements, certain qualifications, the taxpayer is entitled to the relief afforded to growing corporations, that is, corporations whose growth during the base period has been so rapid that it would be unfair to compute their excess-profits-tax credit on a straight average.

The statute further provides that the taxpayer's earnings history can include the earnings of, and its existence can be traced back through the existence of, the corporations from which the components of the corporations have acquired properties—corporations which the components have taken over—that is, it can rely on its predecessor's predecessors, to be nontechnical.

By statute the same rule applies to a taxpaying corporation which takes over the properties of a partnership or a sole proprietorship.

Let me say that, for brevity's sake, hereafter when I mention a "partnership" I mean a partnership or proprietorship.

In operation, however, there has been added to the statute a condition or limitation not written into the statute itself: that the relief provisions will be applied with respect to properties acquired from a partnership only where there has been no change in the composition of the partnership.

This additional limitation results from the Bureau's interpretation, and is evidenced by one of its regulations promulgated under section

740 of the World War II law—which is almost identical to the present section.

I want to say that as late as last Friday I checked, and I found that the Bureau has not yet prepared regulations under the section of the present law.

Senator TAFT. You mean the Bureau has not yet prepared any regulations under the new excess profits tax law?

Mr. KING. Oh, yes, Senator, but not under this particular provision, part II.

Senator TAFT. I see.

Mr. KING. The only thing—the old regulation said in detail that a partnership cannot be an acquiring corporation. That means that where a partnership has taken over properties or where there has been any change in the composition of the partnership, the corporation cannot go back beyond that change.

This regulation under the old law, has been before the courts in several cases, and the Tax Court has looked at the regulation and said that it is "reasonable."

The courts have not examined the intent of Congress behind the regulation. To us this appears to be bureau-made law, and not in accord with the intent of the Congress.

This interpretation may deny relief to a corporation because of the merest accident in the history of the predecessor partnership, such as the withdrawal or addition of a partner, or the death of a partner.

Actually, there is no requirement in the statute that the partnership shall have been engaged in business without any change in its composition up to the time of the transfer of its properties to the corporation.

What Congress intended, we submit, was that a corporation which succeeded in a tax-free exchange to substantially all of the properties which had been utilized in a business—whether conducted by a corporation or by a partnership—would be entitled to utilize the earnings experience of the business and properties during the period of their operations.

It is the income from the properties that Congress had in mind. Congress has not required that the relief would be applicable only in the case of a partnership transferring its properties to a corporation without any change in the ownership of the properties prior to the transfer.

Instead, Congress used the words "a corporation which has acquired." The relief is afforded to a corporation which has acquired.

If Congress intended to confine the relief only to those situations covered by the Bureau's interpretation, it could easily have done so.

The incongruity of the Bureau's position is shown by the fact that if there had been a corporate set-up all the way back through the business it would not have made any difference if there had been a dozen or a hundred transfers of 100 percent of the stock of any of the component corporations during the entire base period.

Senator TAFT. Don't they let you go back as long as the corporation is the same, exactly the same, as it was before—as long as the partnership was exactly the same when the corporation took it over, that they let you go back to the last change——

Mr. KING. That is correct.

Senator TAFT. And then stop?

Mr. KING. That is correct, sir.

We feel that an amendment is needed either to repudiate the interpretation of the section by the Bureau, or to assure, through the language of the statute, a uniform nondiscriminatory application of the law.

I have suggested in my prepared statement—and I ask that the full text of that statement be made part of the record—the language of an amendment which would accomplish the purpose which we have in mind.

The proposed amendment would give to corporations which have acquired partnership properties after reorganization of a partnership, the same treatment accorded to those corporations which have taken over properties from other corporations or from partnerships which have been in continuous and unchanged existence during the entire base period.

At the same time, this treatment would be available only where there has been an actual and true continuity of business, and discrimination would be done away with.

I am told by other practitioners that this is a fairly common situation with small businesses. I know that a number of small businesses represented by friends of mine feel that they are being discriminated against, and that they have no hope of relief.

I am going to take about 2 minutes to talk about my client and trace the history of my client to illustrate the operation of the law under the Bureau's interpretation.

Until July of 1940, Saul Wixson was a dragline and cableway operator, working on dam construction jobs. He was cableway and rigging superintendent in the construction of Boulder and Shasta Dams.

In 1940, Mr. Wixson formed a partnership with J. H. Crowe, of Redding, Calif., and the firm entered the field of general contracting. During the early months of the enterprise, considerable sums were advanced to the partners by Mr. Frank Crowe, Mr. J. H. Crowe's uncle. Mr. Frank Crowe decided to leave this money in the business instead of demanding its repayment, and thereby purchased a one-third interest in the business, which he turned over to trustees for his daughters. The firm thereby became, effective January 2, 1941, a three-way partnership.

On April 30, 1946 (just after the beginning of the excess-profits-tax base period) the trust withdrew as a partner, because the trustees felt that the contracting business was so hazardous that trust funds should not be invested in it.

Mr. Wixson and Mr. J. H. Crowe bought out the interest of the trust.

Let me emphasize, gentlemen, that in no case was there a split-up of the assets. Through each of these changes the assets continued, and the continuing partners bought out, for cash, the interest of the retiring partners.

Early in 1947, Mr. Crowe decided to retire from the contracting business. Mr. Wixson bought out his interest, and after February 28, 1947, he transacted business as a sole proprietor under the firm name of "Wixson & Crowe" until June 1, 1949, when the present corporation was formed and the business and its assets transferred to it in a 112 (b) (5) transaction.

In August of 1949, the new corporation first bid on the Hungry Horse project. There are some interesting figures on it in my prepared statement which I will not take your time with now.

The net result is that after a series of bids, this job was done for the Government at a savings of millions of dollars at a fixed-price contract which was let months before Korea, a year before Congress started to consider the excess-profits tax, and over 6 months before the effective date of the Excess Profits Tax Act.

It is questionable whether in truth there are really any excess profits. We are not making any point of that; we want to pay excess-profits taxes the same as everybody else, but we do contend that we should not be peanlized by an unfair, discriminatory application of the taxing laws.

Wixson & Crowe, Inc., should not pay one cent more tax than it would have if Mr. Wixson had conducted the business as a sole proprietor from the first day of 1946 until the transfer to the corporation or if Mr. Wixson and Mr. Crowe had been partners during all of the base period and until the transfer.

Nobody can be certain of any such thing, but I am as certain as I can be that under the old law, Wixson & Crowe would have had a good chance for relief under section 722.

I am even more certain that they have no chance for relief under the law as presently applied. The only possibility of preventing the discrimination against these small businesses is for this committee to recommend some such amendment as I have suggested.

In addition to the statement which I ask to be filed, I have asked the clerk to give to each of the members of the committee a printed statement which goes a little more fully into this problem.

I have never felt that I have placed a matter before a tribunal from which I could expect better results than I do from you gentlemen.

Thank you.

Senator BYRD. Thank you very much, Mr. King.

Senator TAFT. May I ask, Mr. Stam, has that question been up with your committee? Has it been up with your staff, Mr. Stam?

Mr. STAM. We have discussed it with Mr. King, and we have the matter——

Senator TAFT. Do you see any particular reason why it should not be done? Is there any argument against it?

Mr. STAM. I think it is a matter that we certainly should try to see if we cannot remedy without opening the door too wide in a lot of other cases.

Of course, the whole problem where you have what we call a closed transaction is that where part of the assets go over and part are retained, you get into this question of a double credit; and that is, the old company continues to keep the credit and the new company gets the same credit, and we have tried to work out many of these tax-free exchange provisions under this particular section to keep the credit in the hands of just one taxpayer.

Senator TAFT. Does this involve not only the question of the excess profits tax base, but also the question of tax-free exchange?

Mr. STAM. It involves really the question of excess profits tax base, but it is tied up with the tax-free exchange.

Mr. KING. May I come in again, sir?

Senator TAFT. Yes.

Mr. KING. The difficulty is, of course, as Mr. Stam has pointed out, that where you have transfers from one corporation to another you can come in within the tax-free exchange provisions of the code, but there are no comparable provisions with respect to partnerships. There just is no such thing as a transfer from one partnership to another in a tax-free exchange, so Mr. Stam's point, of course, against double credit is very important from the Government's point of view.

But I think that the matter can be protected, the Government can be protected and, I submit, sir, that my amendment will protect them.

Senator BYRD. Thank you very much, Mr. King.

Mr. KING. Thank you very much, Mr. Chairman.

(The prepared statement of Mr. King, together with a proposal for an amendment referred to by Mr. King, are as follows:)

STATEMENT OF CYRUS B. KING, OF SAN FRANCISCO, CALIF.

Mr. Chairman and members of the committee: My name is Cyrus B. King. I am a member of the State bar of California. I reside and practice in San Francisco, limiting my practice to tax matters.

I represent Wixson & Crowe, Inc., of Redding, Calif. My client is a general contractor, but specializes in clearing dam reservoir sites for the Bureau of Reclamation. Among its larger operations in the past have been clearing the sites for the reservoirs of the Shasta and Cascade Dams and the site for the Seattle-Tacoma Airport. It is currently engaged in clearing the site for the reservoir of the Hungry Horse Dam in Montana.

I have come across the country to appear before this committee because my client, like a number of other small businesses, is being discriminated against in a way that we are sure was not intended by Congress, and because, for reasons I shall develop, apparently only Congress can effectively correct the situation. Because of events which occurred years before the business was incorporated, my client, under present interpretation of the law, will pay a discriminatorily high excess profits tax; in short, while the business has been in continuous existence for over 10 years, it will not be allowed to take into account all of its history as other corporations do, unless Congress clarifies the law.

While I am here to discuss the excess profits tax relief provisions, it is my sincere and considered belief that we are not asking for any new relief provision. We want to call to the attention of the committee the operation of one section of the present provisions. I want to emphasize that word "operation" because, I repeat, we feel that we are not seeking any relief beyond that which has already been provided by the Congress. We do feel, however, that an amendment of the statute is necessary to clarify one of the present provisions, so that the intent of Congress will be carried out and the law will be applied to all taxpayers in a nondiscriminatory manner.

Technicalities are not involved to any great extent, so I shall not have to burden the committee with any technical discussion. Further, to save the time of the committee, I shall, in some instances, oversimplify things. Because I am talking largely about the intent of the law, as we see it, I hope to be able to state my points briefly and simply.

In the present Excess Profits Tax Act, the Congress has wisely omitted such general relief provisions as section 722 of the World War II Act. The expense and difficulty of preparing a case to establish a right to relief under that section, and the uncertainty of the results, led to complaints from taxpayers and their advisers.

Probably because of these complaints,[1] the Congress has written into the present statute a series of definite and more or less automatic relief provisions.[2] These give taxpayers a degree of certainty they didn't have under the former law; they do away with the necessity of employing attorneys, statisticians, economists, and other high-priced specialists and with the expensive and time-consuming

[1] These provisions "of the World War II law have resulted in extended delay in the settlement of relief claims which discriminated against taxpayers who had neither the time nor the financial resources necessary for the establishment of their cases." From House Ways and Means Committee Report 3142, and Senate Finance Committee Report No. 2679, 81st Cong., 2d sess.

[2] The present law "provides relief by a set of formulas, thus reducing the area of administrative discretion to a minimum." Summary of Excess Profits Tax Act of 1950 prepared by the staff of the Joint Committee on Internal Revenue Taxation.

preparation of cases, presentation of those cases to the Bureau of Internal Revenue, and the even more expensive litigation, all of which were engendered by the old law; to that extent that are beneficial.

But the purpose of Congress in establishing the present simpler plan will be thwarted if the language of the statute, or the interpretation of that language by the Bureau of Internal Revenue and the courts, lead to discrimination and to unjustly heavy tax burdens which result from pure accident.

Briefly, our specific problem is this: Part II of the present Excess Profits Tax Act provides that when a tax-paying corporation has acquired the properties of one or more other corporations in tax-free exchanges, the taxpayer may compute its average base period net income by taking into account the earnings history of the properties which it has taken over. That average is used in measuring the extent of the corporation's taxable excess profits. Further, even though the tax payer itself was not in existence on January 1, 1946 (the beginning of the base period for most corporations), it can trace its history back to that date if one or more of its components was in existence then; and, if the entire financial history of the acquiring and the component corporations, taken together, meet certain qualifications, the taxpayer is then entitled to the additional relief afforded to growing corporations, that is, corporations whose growth has been so rapid in the base period that it would be unfair to compute their excess-profits credit on a straight average of actual base period earnings.

The statute further provides that the taxpayer's earnings history can include the earnings of, and its existence can be traced back through, corporations from which the components of the taxpaying corporation have acquired properties; in other words, a component may be made up of its own components.

The same rules apply, by statute, to a taxpaying corporation which takes over the properties of a partnership or a sole proprietorship. And, for brevity's sake, let me say that, hereafter, when I refer to a partnership, I meam a partnership or proprietorship.

In operation, however, there has been added to the statute a condition or limitation not written into the statute itself: That the relief provisions will be applied with respect to properties acquired from a partnership only where there has been no change in the composition of the partnership.

This additional limitation results from the Bureau's interpretation and is evidenced by one of its regulations promulgated under section 740 of the World War II law (which is almost identical to the provisions of the present law as to properties acquired from a partnership). This part of the regulations[3] reads as follows:

"A partnership (or a business owned by a sole proprietorship) can be a component corporation * * *. However, a partnership (or a business owned by a sole proprietorship) cannot be an acquiring corporation, and therefore, * * * (the law) cannot operate to make of its predecessors component corporations of its acquiring corporation."

This regulation has been before the courts in several cases.[4] The courts have held that the regulation is reasonable; but it is submitted that, in no case, has a court squarely considered the question: "Does the regulation express the intent of Congress?"

To us, this appears to be bureau-made law, not in accord with the intent of Congress. This interpretation may deny relief to a corporation because of the merest accident in the history of the predecessor partnership, such as the withdrawal or addition of a partner, or the death of a partner.

Actually, there is no requirement in the statute that the partnership shall have been engaged in business without any change in its composition up to the time of the transfer of its properties to the corporation. The statute does not require that, at the time of the transfer, the properties shall have belonged continuously to the partnership. As a matter of fact, in a number of jurisdictions a partnership is not regarded as a legal entity at all and cannot, as such, own any properties; this rule is particularly true of real estate. Did Congress intend that such a local rule would render this relief inoperative?

It is submitted that what Congress intended was that a corporation which succeeded, in a tax-free exchange, to substantially all of the properties which had been utilized in a business (whether conducted by a corporation or by a partnership) is entitled to utilize the earnings experience of the business and properties during the period of their operations. It is the income from the properties that

[3] Regulations 112, sec. 35.740-4.

[4] See, for instance, *E. T. Renfro Drug Co.*, *11 T. C. 994; affirmed, 183 F. 2d 846; certiorari denied, U. S. Supreme Court, February 26, 1951;* and *Hawaiian Freight Forwarders, Ltd.*, *15 T. C. 55.*

Congress had in mind. Congress has not required that the relief would be applicable only in the case of a partnership transferring its properties to a corporation without any change in the ownership of the properties prior to the transfer. Instead, Congress used the words "a corporation which has acquired." If Congress had intended to confine the relief only to those situations which would be covered by the bureau's interpretation, it could easily have done so; but there would be neither logic nor equity in such a requirement.

The incongruity of the position assumed by the bureau is further highlighted by the fact that a corporation's right to relief would not be affected one iota by a dozen, or a hundred, transfers of 100 percent of the stock of the taxpaying corporation or its components.

But, even if it be admitted for argument's sake that the language of the statute is not clear and that its ambiguity might support the bureau's construction, it cannot be assumed that Congress intended such discrimination. It is submitted, therefore, that an amendment of the statute is necessary, either—

(a) to repudiate the erroneous interpretation; or

(b) to assure a uniform, nondiscriminatory application of the law so that all corporations, large and small, will receive equal treatment.

Because the application of the present relief provisions permits no administrative discretion (except insofar as administrative interpretation may grant or withhold any relief), because the bureau has already indicated its attitude, and because the issue has been clouded by the court decisions I have mentioned, taxpayers who are subject to the discriminatory effects of the law's operation have only one hope of relief: the Congress. That is why we are here.

The discriminatory effects of the present provisions of the law can be obviated by a simple amendment. For this purpose, the following is suggested:

"Sec. —. Acquisition of Properties From Partnerships

"(a) Amendment of section 461 (a).—Section 461 (a) is hereby amended by adding, at the end thereof, the following new sentence: "'Subparagraph (D) shall apply with respect to properties acquired from a partnership despite the fact that, prior to said acquisition, (i) there have been deaths of partners, or withdrawals of partners from, or addition of partners to, the partnership, or (ii) the properties have been transferred from a partnership to a sole proprietor, or from a sole proprietor to a partnership, or (iii) there has been any change in the ownership of the properties through any combination of any of the events mentioned in clauses (i) or (ii) of this sentence: *Provided that*, during the base period and until the said acquisition, at least one individual, a member of the partnership from which the properties were acquired, had been owner of the said properties or a member of a partnership which had been the owner of said properties.'

"(b) Effective date.—The amendment made by this section shall be applicable to taxable years ending after June 30, 1950."

This proposed amendment would give to corporations which have acquired partnership properties after reorganization of the partnership the same treatment accorded to those corporations which have acquired properties either from other corporations or from partnerships which have been in continuous and unchanged existence during the entire base period. At the same time this treatment would be available only where there has been an actual and true continuity of the business. Discrimination and unfairness in the application of the relief provisions would thus be done away with.

While, of course, I am authorized to speak only on behalf of my client, I would say to the committee that I gather from discussions with other practitioners that there are a number of small businesses similarly situated and that their owners and advisers feel that they are being discriminated against.

The essential justice of the proposal is illustrated by the history of my client. Until July of 1940 Saul Wixson was a dragline and cableway operator, working on dam construction jobs. He was cableway and rigging superintendent in the construction of Boulder and Shasta Dams.

Then Mr. Wixson formed a partnership with J. H. Crowe of Redding, Calif., and the firm entered the field of general contracting. During the early months of the enterprise, considerable sums were advanced to the partners by Mr. Frank Crowe, Mr. J. H. Crowe's uncle. Mr. Frank Crowe decided to leave this money in the business, instead of demanding its repayment, and thereby purchased a one-third interest in the business, which he turned over to trustees for his daughters. The firm thereby became, effective January 2, 1941, a three-way partnership.

On April 30, 1946 (just after the beginning of the excess-profits tax base period), the trust withdrew as a partner because the trustees felt that the contracting business was so hazardous that trust funds should not be invested in it; Mr. Wixson and Mr. J. H. Crowe bought out the interest of the trust.

Early in 1947, Mr. Crowe decided to retire from the contracting business. Mr. Wixson bought out his interest and, after February 28, 1947, transacted business as a sole proprietor under the firm name of Wixson & Crowe until June 1, 1949, when the present corporation was formed, and the business and its assets transferred to it in a 112 (b) (5) transaction.

In August of 1949, the new corporation first bid on the Hungry Horse project. Its first bid was made jointly with J. H. Trisdale, Inc., and was for $8,384,670 (the highest bid was $11,250,190). For various reasons, not material to this statement, all bids made at that time were rejected, as were all other bids submitted for the same project on September 26, 1949, except for one schedule covering 1,000 acres, which was awarded for $475,000. A third set of bids was submitted December 20, 1949; at this time Wixson & Crowe, Inc., bid for about one-half of the remaining work, and J. H. Trisdale, Inc., for the other half. Their respective bids were accepted, for a total of $4,931,210; the Bureau of Reclamation's engineer's estimate for the project was $6,231,850.

The startling difference between the first and final bids (and between the Bureau's final estimate and the final bid) is attributable solely to one fact: Mr. Wixson had invented and perfected a new device and a new method for clearing operations. It would be inappropriate to describe this device and method in this statement, but it has been given wide publicity in technical, and even popular, periodicals.

Here, then, is a situation in which, over 6 months before the invasion of Korea, almost a full year before the Congress started to consider the Excess Profits Tax Act of 1950, over 6 months before the effective date of that act, and a full year before the adoption of our present high military budget, a corporation undertook a fixed-price contract at a price which saved the United States Government millions of dollars. The only effect of hostilities and a large military budget on this contract could be to lessen the contractor's profit because of the spiraling costs of labor, equipment, and materials resulting from the present economy. Surely, in truth, none of the profits from this contract can actually be excess.

At the least, it must be conceded that the contractor should not be penalized by an unfair, discriminatory application of the taxing laws. Wixson & Crowe, Inc., should not pay one cent more tax than it would have if Mr. Wixson had conducted the business as a sole proprietor from the first day of 1946 until the transfer to the corporation, or if Mr. Wixson and Mr. Crowe had been partners during all of the base period and until the transfer.

I am as certain as I can be of any such thing that Wixson & Crowe, Inc., would have had a good chance for relief under the old section 722. I am even more certain that, for the reasons I have tried to explain, there is no hope for relief under the mechanics of the act as presently administered by the Bureau. This committee by recommending such a clarifying amendment as I suggest can remove the existing discrimination and can assure that the law will be applied to all taxpayers, large and small alike. We, therefore, respectfully request your favorable consideration of our request.

A Proposal for an Amendment of the Excess Profits Tax Relief Provisions To Prevent Discrimination

(By Cyrus B. King, San Francisco, Calif.)

I. THE PROBLEM

Drafting an excess-profits tax law is probably the most difficult task of the congressional committees which have the responsibility for tax legislation.

The difficulty arises from the effort to tax only those profits which are truly excess [1] and from the necessity of laying down rules which will determine what part of a corporation's profits is excess and what part is normal or average. One of the rules permits this determination to be made by comparing the earnings of a corporation before the years covered by the excess-profits tax with its earnings

[1] "An excess-profits tax selects for additional tax those corporations whose profits are higher than they probably would have been in the absence of hostilities and a large military budget." House Ways and Means Committee Report No. 3142, 81st Cong., 2d sess.

"One of the main advantages of an excess-profits tax in periods of large military expansion is that it selects for additional tax those corporations whose profits are higher than they would have been in the absence of hostilities and a large military budget." Senate Finance Committee Report No. 2679, 81st Cong., 2d sess.

during those years; it is assumed that, to some extent, if the earnings in the latter years are greater, the difference constitutes excess profits.[2] But no single yardstick will apply to all the numberless forms and kinds of American business enterprises. The Congress has, therefore, always included relief provisions, the general purpose of which is to insure, so far as possible, uniform and just application of the tax.

Under the World War II law, relief was provided, among other ways, by such general relief provisions as section 722. Under this section, within broad limits, a taxpayer was allowed to reconstruct a substitute level of normal earnings[3] if, due to any one of many specified conditions, its actual prior normal earnings were not truly representative of its normal earnings during the excess-profits-tax years. The application of these general relief provisions involved highly technical and expensive processes and called for the services of expert lawyers, accountants, economists, statisticians, and other specialists.

Many taxpayers and their advisers complained about the operation and the uncertainty of these provisions. Probably because of these complaints,[4] the Congress has written into the present statute a series of definite and more-or-less automatic relief provisions.[5] These give taxpayers a degree of certainty they didn't have under the former law; they do away with the expensive and time-consuming preparation of cases, presentation of those cases to the Bureau of Internal Revenue, and the even more expensive court litigation, all of which were engendered by the old law; to that extent they are beneficial.

But the benevolent effects of the present relief provisions will be greatly diminished if they, or their interpretation by the Bureau of Internal Revenue and the courts, lead to discrimination or to unjustly heavy tax burdens which result from pure accident.

The purpose of this statement is to call attention to one such provision and to the need for its amendment and clarification.

For the sake of brevity, the problem will be stated as simply as possible, and many of the complexities of the law will be disregarded.

To determine what portion of a corporation's profits are excess under the present law, the taxpayer may compare them with its profits, after certain adjustments, during a 4-year base period, generally the calendar years 1946-49. To the extent that a corporation's profits in the current year exceed a percentage of the average yearly profits during that base period, they are taxed as excess. For this purpose, 85 percent of the base-period average (which incidentally can be arrived at only by computations and adjustments so involved that space does not permit discussion of them here) is called the excess-profits credit.

Example.—Assume that in each of the years 1946-49 a corporation had a net profit of $100,000, and that, under the law, no adjustments would be required to determine the average (a most unlikely assumption). The average base-period net income would be $100,000; and any profits of the corporation after July 1, 1950, or in later years in excess of $85,000 would be taxed as excess profits.

There are many kinds of circumstances under which this formula will not establish a fair or equitable credit. This statement will cover one such circumstance which points to the need, mentioned above, of an amendment: the problem of the corporation which has not been in existence in its present form for the full 4 years of the base period.

For many reasons, the make-up and form of business enterprises change frequently. A corporation will merge with another, or will take over other corporations. A corporation may split into two or more separate entities. A partnership may incorporate. A sole proprietor may take in a partner. A partner may die, and, under State law, a new parternship may result. Despite any of these, or other sorts of changes of form, there may well be, in any case, an actual continuity of the business and of its capital, its assets, its management, and its true business experience. In such case, the present corporation should be allowed to measure the extent of its excess profits by the normal profits of its predecessors.

[2] The other method of measuring excess profits, based on the rate of return on capital, is not considered in this statement.

[3] "Under sec. 722 a hypothetical base-period earnings, credit had to be tailor-made for the individual taxpayer on the basis of almost all the factors which influenced the taxpayer's business during the base-period years." Summary of Excess Profits Tax Act of 1950 prepared by the Staff of the Joint Committee on Internal Revenue Taxation.

[4] These provisions "of the World War II law have resulted in extended delay in the settlement of relief claims which discriminated against taxpayers who had neither the time nor the financial resources necessary for the establishment of their cases." From both the House and Senate committee reports cited in footnote 1.

[5] The present law "provides relief by a set of formulas, thus reducing the area of administrative discretion to a minimum." From the joint staff's summary, cited in footnote 3.

The present law provides for some of these situations; but, as interpreted, it does not cover all of them, and therein lies the possibility of discrimination.

Under part II of subchapter D (secs. 461–466) of the Internal Revenue Code (part of the present excess-profits-tax law), a reorganized corporation can generally take advantage of the earnings history of its predecessors; and, if one or more of those predecessors had, in turn, been a reorganized corporation, the present corporation can go back and use the earnings history of the predecessors' predecessors. To express this in terms of the technical language of the law, an acquiring corporation can carry its existence and financial history back through its component corporations; and one or more of the components of a present and existing corporation can be an acquiring corporation as to its components.

Example.—The White corporation was in existence on January 1, 1946. In 1947, the Black corporation was formed and acquired all of the assets of the White corporation in exchange for the Black stock. In 1949, the Green corporation acquired the assets of the Black corporation in exchange for voting stock.

The Green corporation will be considered to have been in existence during the entire base period, and can then use the earnings of the White and the Black corporations to measure its excess profits.

Further, if the entire financial history of the "acquiring" and the "component" corporations, taken together, meet certain qualifications, and if the continuity dates back to before January 1, 1946, the existing corporation is entitled to other relief afforded to "growing corporations," that is, corporations whose growth has been so rapid in the base period that it would be unfair to compute their excess profits credit on a straight average of actual base period earnings.[6]

These provisions as to reorganizations also apply to a corporation which "has acquired substantially all of the properties of a partnership" (or a sole proprietorship) in a tax-free exchange.[7] So, all of the benefits of these provisions apply to a corporation which took over a partnership (or a sole proprietorship) which existed on January 1, 1946.

But—and here is the problem toward which this statement is directed—the Bureau and the courts have read into the law a requirement which doesn't appear in the statute: that, to get the benefits of this relief provision, the partnership or proprietorship must have existed in exactly the same form during the entire base period and until its properties were acquired by the corporation.

Examples.—(1) If the partnership of Brown & White existed on January 1, 1946, and, in 1949, the partners decided to incorporate, the resulting corporation could base its excess profits tax credit on its own earnings history and that of the old partnership, and its "growth" would be measured from January 1, 1946.

(2) But, according to the Bureau of Internal Revenue, if Mr. Brown had conducted the business as a sole proprietor until 1948, and then had taken Mr. White in as a partner; and if the partners incorporated in 1949, the corporation could not take into account any of the financial history of the enterprise before the date of the formation of the partnership. Further, it could not qualify for relief as a "growing corporation" because its "component" was not in existence on January 1, 1946.

(3) On the other hand, if Mr. Brown had been the sole proprietor of the business until 1949, had then incorporated, and thereafter sold an interest in the corporation to Mr. White, the corporation could trace its existence and earnings history back to the beginning of 1946.

(4) If, in the example No. 1 above, Mr. White had died just before the incorporation and Mr. Brown had brought out his interest, the corporation would probably[8] not have been entitled to relief.

These examples clearly show that the relief offered by the law may be afforded, or denied, to a particular corporation, depending on pure accident.

It is submitted that this possibility of discrimination was not intended by Congress. It arises primarily from an interpretation of the Bureau of Internal Revenue, and, secondarily, from the fact that the wording of the statute is such that its meaning is not clear.

The Bureau's interpretation is evidenced by one of its regulations, promulgated under section 740 of the World War II law (which is almost identical to the provisions of the present law as to properties acquired from a partnership). This part of the regulations[9] reads as follows:

[6] See sec. 435 (e) and 462 (c), IRC.
[7] See secs. 461 (a) (1) (D) and 461 (f), IRC.
[8] Unless, perchance, Brown & White had entered into a particular type of a contract during their lives. See Ransohoff's, Inc., 9 T.C. 376.
[9] Regulations 112, sec. 35.740-4.

"A partnership (or a business owned by a sole proprietorship) can be a component corporation * * *. However, a partnership (or a business owned by a sole proprietorship) cannot be an acquiring corporation and, therefore * * * (the law) cannot operate to make of its predecessors component corporations of its acquiring corporation."

This regulation, and the precise problem toward which this statement is directed has been before the courts in several cases.[10] The courts have held that the regulation is "reasonable"; but it is submitted that, in no case, has a court squarely considered this question: "Does the regulation express the intent of Congress?"

Actually, there is no requirement in the statute that the partnership (or sole proprietorship) shall have been engaged in business without any change in the composition of the partnership up to the time of the transfer of its properties to the corporation. The statute does not require that, at the time of the transfer, the properties shall have belonged continuously to the partnership. As a matter of fact, in a number of jurisdictions a partnership is not regarded as a legal entity at all and cannot, as such, own any properties; this rule is particularly true of real estate. Did Congress intend that such a local rule would render this relief inoperative?

It is submitted that what Congress intended was that a corporation which succeeded directly, or perhaps even indirectly, but in a tax-free exchange, to substantially all of the properties which had been utilized by a partnership is entitled to utilize the earnings experience of the business and properties during the period of their operations. It is the income from the properties that Congress had in mind. Congress has not required that the relief would be applicable only in the case of a partnership (or sole proprietorship) transferring its properties to a corporation without any change in the ownership of the properties prior to the transfer. Instead, Congress used the words "a corporation which has acquired." If Congress had intended to confine the relief only to those situations which would be covered by the Bureau's interpretation, it could easily have done so; but there would be neither logic nor equity in such a requirement.

But, even if it be admitted for argument's sake that the language of the statute is not clear and that its ambiguity might support the Bureau's construction, it cannot be assumed that Congress intended such discrimination. It is submitted, therefore, that an amendment of the statute is necessary, either—

(a) to repudiate the erroneous interpretation; or

(b) to assure a uniform, nondiscriminatory application of the law so that all corporations, large and small, will receive equal treatment.

II. THE REMEDY

The discriminatory effects of the present provisions of the law can be obviated by a simple amendment. For this purpose, the following is suggested:

"SEC.—. ACQUISITION OF PROPERTIES FROM PARTNERSHIPS

"(a) AMENDMENT OF SECTION 461 (a)—Section 461 (a) is hereby amended by adding, at the end thereof, the following new sentence: 'Subparagraph (D) shall apply with respect to properties acquired from a partnership despite the fact that prior to said acquisition, (i) there have been deaths of partners, or withdrawals of partners from, or addition of partners to, the partnership, or (ii) the properties have been transferred from a partnership to a sole proprietor, or from a sole proprietor to a partnership, or (iii) there has been any change in the ownership of the properties through any combination of any of the events mentioned in clauses (i) or (ii) of this sentence, provided that, during the base period and until the said acquisition, at least one individual, a member of the partnership from which the properties were acquired, had been owner of the said properties or a member of a partnership which had been the owner of said properties.'

"(b) EFFECTIVE DATE—The amendment made by this section shall be applicable to taxable years ending after June 30, 1950."

It is submitted that the proposed amendment would give to corporations which have acquired partnership properties after "reorganization" of the partnership the same treatment accorded to those corporations which have acquired properties either from other corporations or from partnerships (or sole proprietorships)

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[10] See, for instance, E. T. Renfro Drug Co., 11 T.C. 994; affirmed, 183 F. 2d 846; certiorari denied, U. S. Supreme Court, February 26, 1951 and Hawaiian Freight Forwarders, Ltd., 15 T.C. 35.

The Renfro case involved a partnership of three persons. The interest of one of the partners was bought by the others before acquisition of the assets of the partnership by the corporation. The Tax Court, after citing and approving of the regulation quoted above, held that the business experience of the partnership during the base period could not be transferred to the corporation because the "intervening proprietors were not 'acquiring corporations' as defined in the * * * Code."

which have been in continuous and unchanged existence during the entire base period. At the same time this treatment would be available only where there has been an actual and true continuity of the business. Discrimination and unfairness in the application of the relief provisions would thus be done away with.

III. AN EXAMPLE

This statement is presented on behalf of Wixson & Crowe, Inc., a Nevada corporation with its main offices in Redding, Calif. It is adversely affected by the discriminatory operation of the present law. In this respect, it is typical of many small corporations throughout the country; its attorneys and accountants have been told by other practioners of many similar cases. To illustrate the sort of injustice that can result from the present law, the following history and facts are presented:

Wixson & Crowe, Inc., is engaged in the general contracting business, but specializes in clearing dam sites for the United States Bureau of Reclamation and similar work. Among its larger operations have been the clearing of the sites of the Shasta and Cascade Dam reservoirs and of the Seattle-Tacoma Airport. It is currently engaged in clearing large portions of the site for the reservoir of Hungry Horse Dam in Montana.

Saul L. Wixson started his business life as a dragline and cableway operator. He worked for years on dam-construction jobs. He was cableway and rigging superintendent in the construction of Boulder and Shasta Dams.

In July of 1940, Mr. Wixson formed a partnership with J. H. Crowe, of Redding, Calif., and the firm entered the field of general contracting. During the early months of the enterprise, considerable sums were advanced to the partners by Mr. Frank Crowe, Mr. J. H. Crowe's uncle. Mr. Frank Crowe decided to leave this money in the business, instead of demanding its repayment, and thereby purchased a one-third interest in the business, which he turned over to trustees for his daughters. The firm thereby became, effective January 2, 1941, a three-way partnership.

During the period of this partnership, the firm was engaged largely in its work on the Shasta Dam Reservoir (1941–43), the Seattle-Tacoma Airport (1943) and some tunneling work (1944–45). The partnership also acquired a ranch as an investment.

On April 30, 1946 (note that this was just after the beginning of the excess-profits tax "base period"), the trust withdrew as a partner because the trustees felt that the contracting business was so hazardous that trust funds should not be invested in it; Mr. Wixson and Mr. J. H. Crowe bought out the interest of the trust. From that date, too, the contracting business and the ranch were conducted as separate partnership enterprises, the contracting business being owned in equal shares by Messrs. Wixson and J. H. Crowe.

Early in 1947, Mr. Crowe decided to retire from the contracting business. Mr. Wixson bought out his interest and, after February 28, 1947, transacted business as a sole proprietor under the firm name of Wixson & Crowe until June 1, 1949, when the present corporation was formed, and the business and its assets transferred to it.[11]

In 1946, 1947, and 1948, the principal project of the enterprise was clearing the site at Cascade Dam in Idaho for the Bureau of Reclamation. In 1948, it also engaged in some tunneling work.

In August of 1949, the new corporation first bid on the Hungry Horse project.[12] Its first bid was made jointly with J. H. Trisdale, Inc. and was for $8,384,670 (the highest bid was $11,256,190). For various reasons, not material to this statement, all bids made at this time were rejected, as were all other bids submitted for the same project on September 26, 1949, except for one schedule covering 1,000 acres, which was awarded for $475,000. A third set of bids was submitted December 20, 1949; at this time Wixson & Crowe, Inc. bid for about one-half of the remaining work, and J. H. Trisdale, Inc. for the other half. Their respective bids were accepted, for a total of $4,931,210; the Bureau of Reclamation's engineer's estimate for the project was $6,231,850.

The startling difference between the first and final bids (and between the Bureau's final estimate and the final bid) is attributable solely to one fact: Mr. Wixson had invented and perfected a new device and a new method for clearing

[11] The transfer was one "to which sec. 112 (b) (5) * * * is applicable," and therefore the corporation became an "acquiring corporation" within the meaning of sec. 461 (a) (1) (D), Internal Revenue Code.

[12] All facts regarding these bids are shown in U. S. Bureau of Reclamation "Abstract of Bids," Spec. R1-HH9, R1-HH10, and R1-HH11, dated, respectively August 23, 1949, September 26, 1949, and December 20, 1949.

operations. It would be inappropriate to describe this device and method in this statement, but it has been given wide publicity in technical, and even popular, periodicals.[13]

Here, then, is a situation in which, over 6 months before the invasion of Korea, almost a full year before the Congress started to consider the Excess Profits Tax Act of 1950, over 6 months before the effective date of that act, and a full year before the adoption of our present high military budget, a corporation undertook a fixed-price contract at a price which saved the United States Government millions of dollars. The only effect "hostilities and a large military budget"[14] could have on this contract would be to lessen the contractor's profit because of the spiraling costs of labor, equipment, and materials resulting from the present economy.

Further, it is to be noted, that the contract was awarded in 1949. Because of climatic conditions, work could not be started until the spring of 1950. Because of the nature of these huge projects, the expenses of the first year's operations are the largest—and the profits consequently the smallest. So, by pure chance, the greatest profits will be earned in the years 1951 and 1952, when they are subject to the full impact of the excess profits tax.

Surely, in truth it must be admitted that none of the profits from this contract can actually be excess. Indeed it might well be argued that, under such circumstances, profits derived from such a contract would properly be exempted from excess profits tax altogether.

At the least, it must be conceded that the contractor shall not be penalized by an unfair, discriminatory application of the taxing laws. Wixson & Crowe, Inc. should not pay one cent more tax than it would have if Mr. Wixson had conducted the business as a sole proprietor from the first day of 1946 until the transfer to the corporation, or if Mr. Wixson and Mr. Crowe had been partners during all of the base period and until the transfer.

The accountants for the corporation have advised that, under present law, its "excess profits tax credit" will be about $78,000. If, however, it were not prevented by the present discriminatory statute and its interpretation from tracing its earnings and history back to January 1, 1946, the credit would be about $186,300. The difference between those two figures can be taxed each year, under present law at 30 percent, and at whatever higher rate the Congress may have to fix the excess profits tax in the future.

The history of this enterprise clearly illustrates the need, the justice, and the equity of the proposed amendment.

Senator BYRD. Our next witness is Mr. J. P. Wenchel, attorney at law.

STATEMENT OF J. P. WENCHEL, ATTORNEY AT LAW

Mr. WENCHEL. Mr. Chairman, and gentlemen of the committee, I can save a lot of time if you will permit me to file my statement.

Senator BYRD. We certainly will permit you to do so, Mr. Wenchel.

Mr. WENCHEL. I have extra copies.

My name is J. P. Wenchel, and I am an attorney with offices at 1625 K Street NW., Washington, D. C.

Senator BYRD. Who do you represent?

Mr. WENCHEL. I represent the Lerner Stores Corp., Howard Stores Corp., A. S. Beck Shoe Corp., Lane Bryant, Inc., Dejay Stores; Miles Shoes, Inc., and Edison Bros. Stores, Inc.

Thank you very much.

Senator MILLIKIN. Thank you.

Senator BYRD. Thank you very much.

Senator TAFT. It is the $25,000 question.

(The prepared statement of J. P. Wenchel is as follows:)

[13] See, for instance: The Reclamation Era, official publication of the Bureau of Reclamation, January 1951; Western Construction, July 1950; Excavating Engineer, August 1950; and Popular Mechanics Magazine, August 1950.

[14] See footnote 1.

STATEMENT OF J. P. WENCHEL

My name is J. P. Wenchel. I am an attorney at law with offices at 1025 K Street NW., Washington, D. C. I appear here as counsel for Lerner Stores Corp., Howard Stores Corp., A. S. Beck Shoe Corp., Lane Bryant, Inc., Dejay Stores, Inc., Miles Shoes, Inc., and Edison Bros. Stores, Inc., all retail chain-store organizations.

My purpose in appearing here is to register the opposition of these organizations to section 123 of the revenue bill of 1951, which proposes to place a limitation on the surtax exemption and minimum excess-profits credit of related corporations.

The use of related corporations is not new. Long before there could have been any tax advantage involved and, in many cases, long before there were any income taxes at all, the multi-corporate set-up was used for good and valid business reasons. Some of the objectives deemed desirable or necessary have been the following:

1. To limit liability on leases, mortgages, contracts, or other claims.
2. To eliminate allocation or other similar problems under State franchise or income-tax laws.
3. To retain the good will of corporations purchased as going concerns.
4. To separate manufacturing from retail activities or otherwise to separate reals estate and other unrelated activities.
5. To segregate the activities of high-grade and popular-priced stores.
6. To act as a possible hedge against anti-chain-store legislation.

The organizations on whose behalf I appear adopted the separate corporation procedure many years ago for one or more of the foregoing reasons and not for tax purposes. Let me cite several examples.

One organization commenced business with a single corporation in 1920 and still operates most of its units as part of the original corporation. However, as it acquired manufacturing plants, it prudently kept them as separate corporations. It did the same thing when it acquired additional stores which were already in operation and which it continued to operate under the old names. It now has 17 corporations; 14 of these were incorporated prior to 1940. Of the three corporations formed after 1940, one operates a manufacturing plant, the second is a textile converter, and the third acts as a wholesaler. Certainly no one can say that there has been an artificial splitting up in this case.

Another of the organizations was caused to recognize during the depression because the rentals under the leases of some of its stores were so high that not only were the operations of those stores made unprofitable, but in addition the entire chain was threatened. In 1932, having learned its lesson by bitter experience, it established a separate corporation for its operations in each State. In some cases where a particularly large operation has been contemplated, the organization has gone one step further and has insulated the particular unit from the others by forming a separate corporation. In most cases, however, each corporation owns a number of stores.

Another organization has separate corporations because it purchased some of its stores as going concerns and has continued to operate these stores as separate businesses under their old names. This has enabled it to hold the good will (for which it paid substantial amounts of money) of the former proprietors. It also maintains several separate real-estate corporations for buildings on which there are large mortgages. Most of its corporations were organized prior to 1942, six of them in 1920 or earlier years.

Another organization has over 200 stores. Despite the large number of stores, it has only 19 store-operating corporations, each of which, except in one instance, operates all of the stores in its State. Fifteen of the corporations were organized in the twenties or thirties.

The business reasons which prompted these and other organizations over the years to form separate corporations are still valid and I do not think that an attempt would be made to change the law if it were not for the fear expressed in the House committee report that corporations would be artificially split up. Moreover, I believe that the revenue effects of the proposed new section have been greatly overestimated. I also am of the opinion that the adoption of section 123 will not cure the evil and that, in the process, many innocent taxpayers will be penalized.

Let us take first those presently existing corporations which fall within the definitions provided by section 123. Many undoubtedly will continue to follow the practice of filing consolidated returns, and as to them the proposed section would take away nothing. As to many of the remaining number, the forced division of the excess-profits-tax credit also would mean nothing since their credits already are equal to or greater than the minimum provided by law. Some, it might seem, would benefit from separate credits and from separate surtax exemptions. The position of these companies, however, is not one of unmixed blessing. By filing separate returns, the gains of one corporation cannot be offset against the losses of another, and the adverse effects of this in dollars and cents may in a single year wipe out any apparent advantage otherwise gained. Again, there is the matter of the 85 percent limitation on the credit for dividends received, which offsets in whole or in part the benefit of a separate surtax exemption.

In this connection I would like to say that the Congress has always sought in a spirit of fairness to make the tax laws of this country consistent. If section 123 should be adopted, then in the same spirit of fairness and justice the law also should be changed to provide a full 100 percent credit for dividends received from related corporations. The section is bottomed upon the premise that the income of two or more corporations owned entirely or almost entirely by the same corporation or by the same individuals is really the income of but one corporation. If this be so, then, by the same token, the transfer of what we now call a dividend from a subsidiary to a parent corporation should have no tax significance, and accordingly no additional tax should be due. Similarly, if separate entities are to be disregarded then there is no justification for the retention of the 2 percent tax now paid for the privilege of filing consolidated returns.

I think, however, there is much wrong in the philosophy that, under the circumstances described in section 123, the income of two corporations should be regarded as if it were the income of but one company. By way of illustration, assume that Mr. A owns a retail store which he operates in corporate form. Last year the company had a net income before taxes of $30,000. If this year the company has a net income of $50,000, it will pay more in taxes and, in fact, Mr. A will expect a larger tax bill. Suppose, however, that after much deliberation Mr. A opens a new store in a different part of the city or in a nearby town, which store is separately incorporated. Assume, further, that the old company again makes $30,000, and that the new store earns $20,000. I think Mr. A would be more than perturbed to find that the tax of the old company had greatly increased. He would argue, and rightly so, that in order to start the new business he had risked what was to him a great deal of capital, and the new company should therefore have the same benefits as any other new company, regardless of its ownership.

The proposed law will work a severe hardship upon some related corporations whether they be large or small and regardless of how long and for what valid reasons they were organized. It will also work a hardship upon the small-business man who might otherwise risk his capital in new ventures or expand his activities by purchasing an existing business. While the proposed section would work these inequities, I doubt very much if it will stop those who are seriously interested in obtaining additional exemptions and credits. If the owners of an existing corporation are thus inclined, apparently all that is necessary is for their corporation to form a new subsidiary and to sell to others 6 percent of the voting stock of that new company. That part of section 123 which deals with the ownership by individuals of two or more corporations is apparently equally susceptible of tax avoidance by those who would so use it.

On the other hand, the long-established multicorporate organizations, for very practical reasons, cannot indulge in the same sort of shifting about even if they wished to do so. The new section therefore will hit those who have conducted their affairs as prudent men would do and with no thought of tax advantage but will not affect the real tax avoiders. The proposed section comes upon the long-established related corporations as a penalty for having followed the correct business route.

Under the foregoing circumstances I believe that careful consideration should be given to the effects of this proposal. I do not think that it will aid small business. It will inhibit expansion. It will impose severe penalties upon establishments which adopted the related corporation basis for valid and sound reasons. If it is intended to close a tax-avoidance loophole it will not be effective and it is much too broad, since it brings within its purview not only the potential tax avoiders but also many others who have conducted their affairs in a prudent and businesslike fashion for many years.

Senator BYRD. In lieu of an appearance the Chair inserts the statement of the Reynolds Metal Co.

STATEMENT OF RICHARD S. REYNOLDS, JR., PRESIDENT OF REYNOLDS METALS CO.

I am Richard S. Reynolds, Jr., president of the Reynolds Metals Co., of Richmond, Va.

I am mindful of the terrific problem involved in trying to bring equity into any excess-profits tax law. When the Committee on Finance wrote the relief provisions in the act, it doubtless thought that they would be adequate to cover any hardship situations which might be encountered by a company such as ours. We, too, had that hope.

I regret to report that not one of the so-called relief provisions will relieve Reynolds from excessive and discriminatory taxation on its normal earnings. No formula contained in the law meets our situation. I therefore desire to bring to your attention the situation of our company.

WHY REYNOLDS SHOULD HAVE RELIEF

The Reynolds Metals Co. and its subsidiaries mine bauxite, extract alumina from the bauxite ore, and reduce this to aluminum. In addition to the production of primary aluminum, Reynolds has extensive fabricating facilities. It owns ore deposits in Arkansas and Jamaica, and its manufacturing interests extend into the States of Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Illinois, Indiana, Kentucky, Michigan, Missouri, New Jersey, New York, Oregon, Pennsylvania, Tennessee, Texas, Virginia, and Washington.

From its outset, Reynolds has been the apostle of expanded production and low cost. Since commencing the production of primary aluminum 10 years ago, it has greatly expanded its productive capacity. During the 5 years since the war, it has explored and developed new ore deposits, has acquired extensive plant facilities, and has proceeded continuously to integrate and improve its facilities and capacity. Even in the latter part of 1949 it launched a substantial increase in its capacity for peacetime use of aluminum, an increase in capacity which was just completed in the second half of 1950.

The base period determined by Congress to be used in the application of the excess-profits tax is unreasonable, inequitable, and unfair as it applies to Reynolds.

The base period fixed by Congress for determining our "normal earnings" is precisely the period when we as newcomers to peacetime operation in the aluminum field were attempting to expand our plants, create new products, and develop new outlets for aluminum. These were the features receiving our main effort; we were anticipating normal profits in the future and were engaged in building up to reach that objective.

In 1945, the year immediately preceding the base period, Reynolds' production of primary aluminum was 137,713,707 pounds. But during the base period, 1946 through 1949, Reynolds was greatly expanding its production. In pounds of metal Reynolds produced—

	Pounds
In 1946	184, 388, 235
In 1947	320, 480, 084
In 1948	338, 313, 153
In 1949	364, 654, 635

Over 1946, the year 1949 was an increase of approximately 100 percent.

During the 4 years 1946 through 1949 Reynolds spent nearly $95,000,000 for new plant and facilities. From the beginning to the end of the base period the Reynolds investment in plant and equipment increased more than four times.

After the war Reynolds sought to secure markets for primary production because it was a new producer of aluminum with no established outlets. Many new end products were manufactured, and heavy promotional expenses absorbed part of the earnings of the reduction and fabricating divisions. During the base period Reynolds was experimenting with, developing, and exploiting new products. Among these were roofing, siding, windows, gutters, downspouts, and various other building products, cable, truck bodies, railroad cars, automobiles, various kinds of foil wrap for the preservation of food, etc.

Furthermore, the enormous expansion represented by the postwar quadrupling of its investment in plant and facilities required time for integration and scheduling into an economical and efficient operation.

Despite this great increase in production and in plant investment, Reynolds' dollar profit was the same in 1949, the last year of the base period, as in 1946, the first year in the base period.

Reynolds had been brought to the point where it was just ready to receive the benefit from this huge expansion. It would have done so without regard to mobilization. The base period was not normal, and it is unfair to use it as the standard in determining what earnings are now to be subjected to the excess-profits tax.

In total this expansion was a heavy undertaking. The result is that Reynolds was a low-profit operation throughout the base period. Wholly aside from the events in Korea and the defense demands of the country, Reynolds had been confidently looking forward to the latter part of 1950 and the year 1951 as the time when it would begin to realize the profit normally and reasonably to be expected from these extensive undertakings. The soundness of this view was being demonstrated by the facts. Even prior to Korea the demands made upon it were exceeding its expanded capacity.

The result of these circumstances is that Reynolds has been in a solid but costly state of expansion and integration that would have yielded increased production and profit now and in the immediate future without the occurrence of any of the present critical developments of defense mobilization. The result is also that Reynolds typifies a growth company for which no formula of relief has been enacted. The Excess Profits Tax Act is inflicting a heavy penalty on Reynolds, and at the very time when it is making its maximum effort for defense.

In making the maximum use of its expanded capacity during the present emergency, it is required to accelerate the consumption of its limited domestic sources of bauxite. Furthermore, since Korea, at the urgent request of the Government, it has undertaken heavy financing for still greater productive facilities. It is obvious, however, that its ability to maintain sound and sufficient financing for such expansion (already having reached the sum of $85,000,000) and to do the maximum of which it is capable is affected by its ability to earn a fair profit. Especially is this true since it had already contracted substantial debt in the expansion of its facilities during the years prior to Korea.

Since the normal earnings of Reynolds are now subjected to the extraordinary rate of the excess-profits tax, plain equity and justice call for an amendment which will alleviate the hardship which the Excess Profits Tax Act now imposes, but which was never intended by the Congress.

RECOMMENDED AMENDMENTS

There are several practical ways of giving just and proper relief to Reynolds and other companies deserving of relief, while still subjecting a large part of their earnings to the excess-profits tax:

A lower ceiling—of, say, 60 percent—will be of assistance to all companies injured by the various kinds of unfairness inflicted by the excess-profits tax law.

A revised and strengthened section 722 procedure will eliminate some of the most serious inequities.

Another realistic approach is to grant relief based on the increase in actual production rather than in mere productive capacity without regard to the extent of its use. This should not be tied to such an unrelated criterion as the "average industry base period rate of return." That is so much of a lowest common denominator as to afford no relief at all.

Another approach is an amendment to the strategic-minerals provision by the addition of one more strategic mineral (metallic aluminum) to the 26 already included. This is explained in the next section.

WHY AN AMENDMENT OF THE STRATEGIC-MINERALS PROVISION IS IN THE PUBLIC INTEREST

The basic mineral resources of the Nation are among the richest in the world, and additional ones are constantly being discovered and developed. Not so, however, with bauxite ore, an aluminum-bearing clay, the mineral from which aluminum is made. The most recent, and the most significant, evidence of this fact is the amended MO 5 just issued this month by the Defense Minerals Administration setting forth the procedure under which Government aid may be obtained in financing the cost of projects for exploration for unknown or undeveloped sources of strategic metals or minerals. In the current amendment issued under the authority of the Defense Production Act, bauxite is added to the list of strategic and critical minerals for which the Government will contribute 50 percent of the total cost of the exploration projects. Significantly the list of metals in this MO is almost identical with the strategic minerals in the exemption provision of section 450 of the Excess Profits Tax Act. The same fact which caused the addition of bauxite to the list of strategic minerals included in the regulation for

Government aid in defense exploration projects should cause the adoption of the amendment submitted herewith.

Another proof of the strategic and critical nature of aluminum is the fact that both aluminum and bauxite are on the Munitions Board A list of strategic and critical materials for stockpiling.

Significantly, only in a small restricted area consisting of a portion of but two counties in the lone State of Arkansas is bauxite mined domestically for the production of aluminum. The Government and private interests have spent substantial sums in the search for new deposits of domestic bauxite and other aluminum-bearing clays. The search for and development of this critical and strategic mineral requires Government encouragement in all practical ways. Not only is this in the national interest, as it involves the economic well-being of our civilian economy, but is most important in the furtherance of national defense, since aluminum is indispensable in any modern war effort.

As indicating the dependency of the country upon foreign sources of bauxite, only a relatively small portion of the total virgin aluminum currently produced in the United States is produced from domestic bauxite. So short is the country of domestic bauxite suitable for the economic production of aluminum that the Munitions Board has stockpiled large quantities of imported bauxite. The transportation and storage of this foreign ore has presented difficult problems. This dependency on foreign countries is a burden on our economy and the American taxpayers and should be relieved by Congress if practical means can be found therefor.

One practical means of encouraging the exploration for domestic bauxite and other aluminum-bearing clays and the discovery of feasible and economical means for converting such ore into aluminum would be for Congress to extend to domestic bauxite and other aluminum-bearing clays, and the conversion thereof to a metallic state, the provisions of section 450 of the Excess Profits Tax Act of 1950. It is presently extended in that section to 26 other specifically named critical and strategic minerals and metals, including fluorspar, molybdenum, tungsten, nickel, tin, etc., which are no more critical and strategic than aluminum. After all, the production of aluminum in this country is, at the direction of the Government, being increased to meet the present emergency to a greater extent than is proposed in connection with any other basic critical, or strategic material. The already greatly expanded aluminum industry is at the urgent request of the Government being expanded from 75 to 100 percent.[1]

An amendment, completely consistent with the theory of section 450 as it now appears in the excess-profits tax law, is suggested as follows:

(*a*) Add bauxite (including aluminum-bearing clays) to the list of 26 strategic minerals in section 450 (b) (1).

(*b*) Include the conversion of a strategic mineral so as to cover not only the mining of bauxite but its conversion into primary aluminum.

Attached hereto is a draft of section 450 as so proposed.

The effect of this amendment would be to add primary aluminum to the strategic minerals listed in the act, but only when made from domestic ore. Certainly no metal is more strategic or critical to defense than aluminum.

Since aluminum results from (*a*) the mining of bauxite, (*b*) the extraction of alumina from the ore, and (*c*) the reduction of the alumina to aluminum, it is clear that the simple addition of bauxite to the list of 26 minerals in section 450 (b) (1) is not sufficient. Bauxite is an unconverted ore. In order to obtain aluminum, it is necessary to convert bauxite into alumina and then into the metallic form of aluminum.

There should be an incentive to create processes for the economic conversion of low-grade domestic bauxite and other aluminum-bearing clays into aluminum, since it is now possible but far more costly to convert low-grade bauxite and aluminum-bearing clays with a low alumina content than to convert high-grade imported bauxite with a high aluminum content. The exemption to be effective must therefore apply both to mining and to conversion. Such an incentive should tend to bring the resources of private enterprise into the active exploration for new deposits of bauxite (and other aluminum-bearing clays) and into the research needed for the development of such economical processes.

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[1] In his recent Midyear Economic Report, President Truman confirmed this statement when he said in part:

"The Council of Economic Advisers estimates that we have the ability to increase our total output by at least 5 percent within a year's time. * * * A major obstacle to the further expansion of production is the shortage of capacity in a number of key industries. * * * A number of basic expansion programs have been prepared by the defense agencies, and are now going forward under continuing review. * * * The aluminum program is planned to more than double our 1950 rate of output by the end of 1953. * * *" (Midyear Economic Report of the President to Congress, July 23, 1951.)

The proposed amendment would serve to create new virgin wealth, increase employment, and generate new sources of tax revenue, with resulting benefit to our civilian economy.

If the amendment resulted in bringing about its objective and purpose, it would tend to free the country from its almost complete dependency upon foreign sources of not only a critical and strategic meterial but one without which the country would be defenseless. The enemy now menacing not only our country but the rest of the free world has placed significant emphasis upon a vast modern submarine fleet which it is known to possess. So enormous is its submarine fleet that it doubtless could and would, in the event of war, be employed in such wise as to cut this country completely off from its source of foreign bauxite upon which it is almost entirely dependent. Since that source is restricted to the Caribbean area alone, the Germans in World War II, with nothing like the submarine resources of the present potential enemy, almost succeeded in preventing the importation of bauxite into our ports. Large numbers of ore-carrying vessels were sunk, and the loss of life to our seamen was distressingly high. Thus, if the amendment accomplishes its objective and purpose, it might be the factor determining the success or failure of our whole defense effort, for without aluminum we would be impotent.

SUMMARY AND CONCLUSION

To summarize the foregoing:

Throughout the base period 1946–49 Reynolds was expanding, developing, and integrating, with the result that it was low in profit. During this period it spent nearly $95,000,000 in new plant and equipment; it doubled its production of primary aluminum; it quadrupled its plant investment; but its dollar earnings in 1949 were no greater than in 1946. By 1950 it was ready to reap the benefit from this long and costly preparation. Its demand was already greater than its production by mid-1950. The result is that a lrage part of its normal earnings in 1950 and 1951 (resulting from its pre-Korean expansion) are being unfairly subjected to an excess-profits tax.

We therefore respectfully recommend the following amendments: A lower ceiling; a revised and strengthened section 722 procedure, a relief provision based on the increase in actual production but not tied to an "industry base period rate of return," and the addition of metallic aluminum (produced from domestic ores) to the strategic minerals provisions of section 450.

"SEC. 450. CORPORATIONS ENGAGED IN MINING *OR CONVERSION* OF STRATEGIC MINERALS

[*Additions italicized—No deletions*]

"(a) EXEMPTION FROM TAX.—In the case of any domestic corporation engaged in the mining of a strategic mineral *or the conversion of a strategic mineral into a metallic state*, the portion of the adjusted excess profits net income attributable to such mining in the United States *or such conversion in the United States of a strategic mineral mined in the United States* shall be exempt from the tax imposed by this subchapter. The tax on the remaining portion of such adjusted excess profits net income shall be an amount which bears the same ratio to the tax computed without regard to this section as such remaining portion bears to the entire adjusted excess profits net income.

"(b) DEFINITIONS.—For the purposes of this section—

"(1) the term 'strategic mineral' means antimony, *bauxite (including other aluminum-bearing clays)*, chromite, manganese, nickel, platinum (including the platinum group metals), quicksilver, sheet mica, tantalum, tin, tungsten, vanadium, fluorspar, flake graphite, vermiculite, perlite, long-fibre asbestos in the form of amosite, chrysotile or crocidolite, beryl, cobalt, columbite, corundum, diamonds, kyanite (if equivalent in grade to Indian kyanite), molybdenum, monazite, quartz crystals, and uranium, and any other mineral which the certifying agency has certified to the Secretary as being essential to the defense effort of the United States and as not having been normally produced in appreciable quantities within the United States.

"(2) the term 'certifying agency' means the department, official, corporation, or agency utilized or created to carry out the authority of the President under section 303 (a) of the Defense Production Act of 1950 to make provisions for the encouragement of exploration, development, and mining of critical and strategic minerals and metals.

"(c) CERTIFICATION DURING TAXABLE YEAR OF TAXPAYER.—In determining under subsection (a) the portion of the adjusted excess profits net income which is attributable to the mining of a mineral which is a strategic mineral by reason of a certification made during the taxable year, such protion shall be an amount which bears the same ratio to the portion of the adjusted excess profits net income, determined without regard to this subsection, attributable to such mining during the entire taxable year as the number of days for which the taxpayer held the mineral property during the taxable year and after the date of the making of the certification bears to the number of days for which the taxpayer held the property during such taxable year.

"(d) APPLICATION OF SECTION TO LESSOR.—In the case of a mining property operated under a lease, income attributable to such property derived by a lessor corporation shall, for the purposes of this section, be considered to be income of a corporation engaged in mining."

Senator BYRD. We will recess until 10 o'clock tomorrow morning.

(Whereupon, at 12 noon, the committee recessed to reconvene at 10 a. m. Wednesday, July 25, 1951.)

REVENUE ACT OF 1951

WEDNESDAY, JULY 25, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312 Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd, Johnson (Colorado), Hoey, Kerr, Millikin, Taft, and Williams.

Also present: Senator Warren G. Magnuson, Senator Richard M. Nixon, Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. The meeting will come to order. The first witness is J. Howard Marshall. You have been assigned 15 minutes. Will you identify yourself for the record, sir.

STATEMENT OF J. HOWARD MARSHALL, THE AMERICAN PETROLEUM INSTITUTE, THE WESTERN OIL AND GAS ASSOCIATION, AND THE PACIFIC AMERICAN TANKSHIP ASSOCIATION

Mr. MARSHALL. My name is J. Howard Marshall. I am vice chairman of the board of Ashland Oil & Refining Company, Ashland, Ky., and I appear here today on behalf of the American Petroleum Institute, the Western Oil and Gas Association, and the Pacific American Tankship Association, and in opposition to section 493 of H. R. 4473, The Revenue Act of 1951.

Section 493 would impose a 3 percent tax on the "fair charge" for the transportation of petroleum and petroleum products by water, between points within the United States, where the shipper transports his own oil or oil products in his own vessel or his own barges. My company operates a substantial number of oil barges and towboats on the Ohio and Mississippi Rivers and their tributaries.

By way of personal qualification on matters relating to the petroleum industry in general, I might mention in passing that I served as Assistant Deputy Administrator and chief counsel of the Petroleum Administration for War during World War II and some years before that as a member of the Petroleum Administrative Board of the Department of the Interior from 1933 to 1935.

While this committee has before it the House committee report stating that this particular part of the tax bill would only produce a revenue of $3 million, I do not believe that you have information on the practical effect of such a tax bill, the many inequities it would cause and the extremely burdensome administrative problems it would present.

Senator TAFT. Does this tax relate solely to transportation by water?

Mr. MARSHALL. Solely to transportation by water, Senator Taft, of petroleum and petroleum products that are carried in the shippers' own vessels.

Senator TAFT. It would not apply to a man shipping it in his own trucks, for instance?

Mr. MARSHALL. It would not apply to shipment in his own trucks. It singles out water transportation alone.

For the information of the committee, I wish to submit a summary of the important adverse effects of this proposal. For this purpose I desire to proceed by first examining the theory and effect of transportation taxes in general and then to an analysis of the discrimination and difficulties of administering this particular tax proposed to be levied under H. R. 4473 against one single commodity—petroleum.

The differential between the fortunately situated community and the less fortunately situated community with respect to commerce is the difference in transportation cost. The differential between a limited and an expanded market is transportation cost. The differential between less and more competition is mainly transportation cost. That a less fortunately situated community which must pay high transportation costs naturally should have its existing burdens compounded unnaturally by the imposition of a tax is surely unfair to consumers in areas remote from production. That markets made available by a reasonable transportation cost should be made unavailable by a tax on that transportation cost reverses the free flow of commerce. That competition in a community should be lessened by denying to that community the entry of goods from greater distances because of transportation taxes stifles free enterprise by stifling competition. All of these things are contrary to the public interest.

In the case of oil, for example, is it not bad enough for consumers in New England, along the east coast, the Pacific Northwest, in Virginia or Ohio, or in the great midwestern part of this country to be compelled to pay the cost of transporting an essential commodity from Texas, Oklahoma, Louisiana, or California without having to pay a transportation tax piled on top of a transportation cost? And, to make matters worse, to have that tax levied so that the further away from the source of supply, the higher the tax.

Senator KERR. Does not that principle apply to all transportation costs? Is that not the basis of the principle of the tax on transportation costs of all commodities shipped on the railroads?

Mr. MARSHALL. Senator, that is the basis of transportation costs by rail.

Senator KERR. I mean the cost is based on a flat percentage of the transportation costs; is it not?

Mr. MARSHALL. That is correct.

Senator KERR. And, the further the transportation, the higher the cost?

Mr. MARSHALL. The further the transportation, the higher the cost. And what it does, of course, is to penalize additionally those communities or those States, or those sections of the country, that are far removed from where the particular material is produced.

Senator KERR. I mean, is that not incident to the operation of the principle of the percentage tax on transportation costs?

Mr. MARSHALL. It is.

And I would submit to you, sir, that the theory of that tax, as the method of raising revenue, leaves something to be desired.

Senator KERR. There is no disputing that. But I presume that it is just as certain, as of the present, that not only is the theory but the reality of the tax that we do have with reference to transportation. Is that correct?

Mr. MARSHALL. That is correct, if it be transportation for hire. With respect to private transportation, at the present time no such tax is levied against any commodity.

Senator KERR. With reference to what?

Mr. MARSHALL. With respect to private transportation. If you are a shipper, for example, of gravel or coal or coke or iron ore, in your own equipment, and you owned the commodity, no such tax at the present time is levied; nor is it levied against petroleum or petroleum products.

Senator TAFT. But your present argument is an argument against any tax? It is really a repeal of the 3-percent tax you are advocating?

Mr. MARSHALL. It was merely examining the underlying basis of the whole theory of transportation taxes.

Senator KERR. I would think that your position is that of one of a group of operators who transport their own products. I do not think that there is much probability that there is going to be any change in our tax law of the operation of the percentage factor applied to transportation.

Mr. MARSHALL. Transportation for hire.

Senator KERR. In the event of the tax being levied.

Mr. MARSHALL. I suppose that is true, Senator.

Senator KERR. You do not recommend that?

Mr. MARSHALL. Over the long run, it would seem to me that it would be sounder not to have transportation taxes.

Senator KERR. I think it would be more desirable if you did not have any taxes.

Mr. MARSHALL. Of course. But, as we both recognize, there are many different ways of levying a tax. I am simply saying that as a matter of general theory—and this statement considers it just generally as a starter—in the original days of the establishment of the United States Constitution, as you know, the various States that were fortunately situated tried to levy a tax on their commerce to make the less fortunately situated States pay it. And that was abolished.

Senator KERR. I must say they were amazingly successful in their effort; and, so far as I have been able to determine, still are.

Mr. MARSHALL. Even so, I think——

Senator KERR. But we cannot change that.

Mr. MARSHALL. We both might agree that it was an unsound principle.

Senator KERR. It is a harsh reality.

Mr. MARSHALL. It is a harsh reality.

Senator KERR. Yes.

Mr. MARSHALL. However, my particular point—and I will not debate with you or take the committee's time to discuss the general theory, except to mention in passing that it does seem to me that a transportation tax as such tends to put the Federal Government in the position where it is taxing particular sections of the country in a somewhat discriminatory manner, depending on whether you are fortunate enough to be located close to the source of supply or not.

Senator KERR. Of course, that is immaterial to me, as to how you make the presentation, but I am of the opinion that the presentation of a situation where you seem to be discriminated against as one of many who transport their own products would be far more persuasive than the presentation of a situation that, as I see it, is a reality and probably will be after this bill is rewritten.

Mr. MARSHALL. I am perfectly delighted to do that. And, in my formal statement here, if you will turn to page 4, I deal specifically with the discriminatory——

Senator KERR. No; I do not want you to turn to page 4. Go right ahead.

Mr. MARSHALL (continuing). I deal with the discrimination involved in this particular commodity.

Senator KERR. Go right ahead and make your statement. I just felt that way about what you said.

Mr. MARSHALL. I think, Senator, in the light of our discussion, that I have made the point that is covered in the first three pages of this statement; and, to save the committee's time, I think the point is perfectly clear in the record and that is all that is necessary.

Turning now from the general on to the specific—and now I am turning to page 4 of this statement—the proposed tax contained in section 493 of H. R. 4473 singles out the private transportation of petroleum and its products to the exclusion of all other commodities transported on the navigable waters of the United States by the owners of the commodities themselves, who are also the owners of the barges and vessels used for such purposes. These commodities include: Coal, coke, ores, sand, and gravel, chemicals, grain, sulfur, iron and steel products, lumber, and many other manufactured and fabricated products. The tonnages and the cost of transportation by water of these commodities in the aggregate greatly exceed the volume of petroleum and its products moved by water in equipment owned and operated by oil companies.

Senator KERR. Would you have any estimate of the cash revenue that would be derived by applying the tax to all of these other products equally in the amount as the House bill fixes it with reference to petroleum?

Mr. MARSHALL. No specific figures, but I am sure it would be many, many times.

Senator KERR. On account of the fact that you are positive there is many times the volume of the other commodities?

Mr. MARSHALL. That is correct.

If a Federal tax of this nature has any merit at all, it should be levied against all transportation of all commodities by their owners.

It constitutes, in our judgment, the rankest discrimination to pick out one commodity and one class of consumers for this kind of tax treatment. Surely this committee and the Congress desire to levy needed Federal taxes in a fair and equitable manner and not to discriminate against particular sections of the country and a single commodity, as is the case with respect to section 493 of H. R. 4473 as it was passed by the House of Representatives.

Senator KERR. Now, let me ask you this question: If the tax were left in the bill, it would not per se constitute a tax either against oil or the oil industry, but it would constitute a tax against a very limited number of those engaged in that industry, and to the extent only that they transport their own products?

Mr. MARSHALL. Except this: With respect to very large sections of our country—the east coast is a good example, and the Pacific Northwest another, and the great Middle Western States another—a very, very large proportion of the total amount of petroleum and petroleum products that are supplied to these regions of the country is moved by water, and the great bulk of that is moved by private carriers where the oil company owns the vessel or the barge in which the product is moved.

Senator KERR. Is it not a fact that much more of it is carried by nonprivate carriers?

Mr. MARSHALL. In the case of the east coast——

Senator KERR. I mean, the total volume.

Mr. MARSHALL. The total volume in some certain sections of the country would be almost exclusively by other means of transportation.

On here, on the east coast, and the Pacific Northwest, the east coast ratios, during the war, when World War II broke out, Senator, were that about 90 percent of the total consumption of petroleum and petroleum products on the east coast was moved by water.

Senator KERR. Is it not a fact that, if the tax were permitted to stay, it would be one that would be levied against certain operators in an industry rather than against the industry?

Mr. MARSHALL. It would be levied fundamentally against the consumers of the States dependent upon that method of transportation. It would be paid initially, of course, by the operators and subsequently, of course, by the consumers, in the long run, in the areas in question.

May not this tax on the private transportation of petroleum be used as a precedent for similar taxes on farmers hauling their own products to market in their own vehicles or fishermen moving their own catch in their own boats. Where will it end?

The report of the House committee dealing with section 493 of H. R. 4473 suggests that this proposed tax on the private transportation of petroleum and its products by water is justified because the movement of such commodities by pipeline is subject to a transportation tax. Aside from the fact that some discrimination against particular sections of the country and a particular class of consumers does not justify still more discrimination, as a practical matter, the administration of a pipeline transportation tax, complicated as it is, is simplicity itself compared to what is here proposed on water movements.

In almost every important instance covering pipeline movements, there are definite tariffs on file with Federal or State regulatory authorities. Pipeline routes are definite and fixed; on any particular route equipment is standardized; tariffs once posted change infrequently. But with tankers and barges nothing is or can be standardized. Ports of call, routes, and destinations change constantly just as do the products to be hauled and the equipment in which they are hauled. There are big tankers and little tankers, large and small barges, low-cost and high-cost equipment. Practically all shipping rates are spot rates. They are based on conditions that prevail at the moment such as the availability of the barge or ship at a particular place at a particular time or season, its size, speed, whether in clean oil or crude oil service, whether equipped with heating coils and a multitude of other variables too numerous to mention.

All of the foregoing was recognized in the data on proposed revenue bill of 1942, submitted to Ways and Means Committee by the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation April 24, June 27, 1942. I wish to quote specifically from page 444, exhibit 212—Transportation of property tax 4 (b).

It would be administratively impracticable to extend the tax to cover those businesses that conduct their own transportation service. In the absence of published rate schedules, it probably would be necessary to base the tax on the cost of conducting such service. This determination for literally hundreds of thousands of taxpayers seems an almost impossible task.

It is significant that even in the midst of our greatest war, the Congress of the United States and the Treasury Department did not deem it appropriate to levy a tax on private transportation.

Notwithstanding the modest revenue of $3 million that the House committee states this tax will provide and the warning just quoted to the effect that the collection of a tax on private transportation is administratively impracticable, I do not believe a more difficult collection problem could be found than that associated with the private transportation of petroleum. To give you just a few examples:

Out on our midwestern rivers barging is well over a century old. When it started, single barges were used by after a while two or more barges were tied together and towed in flotilla. Then the barges got bigger and the trips got longer and then it turned out that the towboat could not carry enough fuel for itself so some forgotten genius got the idea of putting the extra fuel for the tow boat in the rake ends of the barges it was pushing because the rake ends were not being used anyhow. This made it possible for the flotilla to keep on moving along day and night and it saved time and was safer.

This bill as passed by the House exempts "transportation in a vessel of products to be used (without unloading) as fuel supplies * * *." Does this exemption include fuel oil carried in barge rakes for the use of the vessel towing the barge?

In this case you will certainly have to pump it out from the rake into the towboat. Is that unloading?

From Texas to Maine and from California to Alaska, there are thousands of small fish, shrimp, sponge, oyster, and lobster boats and even sealers and shalers which operate from base or mother boats. Many of these boats receive their gasoline, diesel, lamp, and lubricating oils in barrels, cans, and other containers.

This proposed tax law does not exclude this packaged oil from tax until it arrives on the boat that uses it. How will this tax be applied in this instance and the many other cases of packaged petroleum products which might be mentioned?

The tax is stated to apply to liquid products of petroleum. There are more than a thousand products of petroleum. Some are gases until they are cooled or compressed in a tank to a liquid. Bottled petroleum gas is commonly used for cooking and heating in millions of homes in rural districts. This commodity is sometimes a liquid and sometimes a gas, depending on temperatures and pressures. What is it under this act when moved by water?

Take the same problem in reverse. There are many petroleum products which only become liquid when heated or in hot weather.

Asphalt, wax, and the heavy lubricating oils and greases are examples. Under this proposed law, are these products' to be taxable in the summer but not in the winter; exempt if shipped cold but not if shipped hot?

Let me suggest a further complication. There are thousands of tons of asphalt used each year in the surfacing of roads. This asphalt is normally solid but to make road oil it is "cut back," that is, dissolved in a thin solvent so it will become a liquid. This process can be safely undertaken at a plant regularly engaged in this blending operation. The product, then, if transported by water, would then be taxable. But if an individual moved his own solid asphalt in his own boat and then blended it or cut it back on the job, presumably he would avoid most of the tax. Does this make any sense?

Take the case of floating service stations which service fishing boats, work boats, and motorboats. Sometimes the oil is brought to them but often they are towed to an oil dock to be filled up after which they return to station to serve other boats. How much transportation tax based on what rate or fair charge will be due in hundreds of cases of this kind?

Given time, gentlemen, I think I could recite for hours the administrative complexities, the lawsuits and arguments that are bound to follow an attempt to apply and collect a private transportation tax on the transportation by water of literally thousands of liquid, semiliquid, liquefiable, solid or semisolid petroleum products moved daily to hundreds of thousands of consumers in a multitude of different types, kinds and sizes of tankers, barges and dry-cargo vessels.

One final point. Not only does the singling out of petroleum for a tax on its private transportation by water between points in the United States discriminate against domestic consumers distant from the sources of supply, but since this tax does not apply to any movement of either petroleum or its refined products from any foreign country into the United States whether for hire or by the owner of the product, the proposed domestic tax actually has the effect of a tariff levied against our own domestic oil producers, refiners, and marketers.

Thank you.

Senator BYRD. Thank you, Mr. Marshall.

Senator BYRD. Dr. Ethan A. Lang.

Dr. Lang, you have been assigned 10 minutes. Will you identify yourself, please?

STATEMENT OF ETHAN A. LANG, COMPTROLLER, CITY OF CAMDEN, N. J.

Mr. LANG. Thank you.

Senator BYRD. I might say that Senator Hendrickson has expressed his interest in your presentation.

Mr. LANG. Thank you.

Gentlemen, I am presently comptroller of the city of Camden, N. J.; former president of the Camden Board of Education, past president of the Middle Atlantic Association of the Amateur Athletic Union, member of the United States Olympic Committee, 1936, and member of the Municipal Finance Officers Association of the United States and Canada.

Mr. Chairman, you undoubtedly have been offered many suggestions and formulas for raising moneys to meet the fiscal needs of our Nation. What I am about to say will not suggest any ways or means of raising money. It will only present the facts of the harm the 20 percent Federal admissions tax has done and is doing to our schools. I have tried to make this report clear and concise.

It might be well, though, to point out that I represent no lobby group. I am not being paid by any individual, organization, or group of organizations, nor do I expect any personal gain from the elimination of the Federal admissions tax as it affects the thousands of primary and secondary schools in the Nation and their vitally important extracurricular programs.

I have been interested in the elimination of the Federal admissions tax for several years. During that time I have used my personal moneys and devoted much of my time and effort to waging, as a citizen, a campaign urging elimination of the tax.

I would like to present, for your consideration, some facts concerning a tax which never should have been enacted. I refer, of course, to the 20 percent Federal admissions tax to school plays, school dances and athletic contests.

Your colleagues in the House of Representatives, realizing what is happening to the school's extracurricular programs mainly because of the serious financial drain caused by the tax, recently approved a tax program that eliminated the admissions tax as it affected nonprofit religious, educational, and charitable institutions.

I feel fairly certain that when you too become cognizant of the same facts realized by the House Members, you will also recommend its elimination.

Gentlemen, following are some examples of hardship imposed on our primary and secondary educational institutions by this most unfair tax. Although the figures are from Camden, N. J., and Philadelphia, Pa., they are typical of a problem facing every primary and secondary school in the Nation.

A financial report of home athletic events at Woodrow Wilson High School, Camden, N. J., submitted by Mitchell Mozeleski, former athletic director, reveals a 1-year deficit of $47.50. Mr. Mozeleski points out that—

> if we did not have to pay the Federal tax, and charged the same admission as we do now, we would have shown a balance of $1,336.14 instead of a deficit.

He substantiates that statement with the following figures:

	Net gate	Federal tax
Football	$3,364.87	$841.36
Basketball	772.77	517.68
Baseball	49.50	24.60
Total	5,187.14	1,383.64

His financial breakdown for the various sports indicates as follows:

	Receipts	Expenditures
Football	$5,835.00	$5,323.88
Basketball	2,185.31	1,077.02
Baseball	71.50	1,187.07
Track		101.63
Tennis		62.70
Total	8,091.81	8,112.33

Then there is a breakdown in my brief of Mr. Mozeleski's figures.

Camden High School is another good example. Carlton R. Hopkins, principal, reported Camden High paid $1,031.91 in Federal admissions tax as a result of sporting events, causing the school, after other expenses, to operate its sports program at a loss of $863. Hopkins attributes that loss directly to the tax and further states, "It eventually will lead to the removal of physical training programs for our youths." He added the Government actually is taxing "athletic programs out of existence."

A spokesman for the public schools in Philadelphia said 10 of the 16 Philadelphia public high schools were in the red on their sports program during the school year recently ended and added most of them would have been able to meet expenses if there had been no Federal tax.

The Philadelphia public high schools paid a total of $10,109 in taxes during the year, including $1,847 which represented half of the Federal levy on city championship games conducted by the Interleague Commission. Parochial schools paid the other half. Among the schools paying heavy taxes on sports were: Southern High School, $1,441, and Frankford High School, $1,145.

Those are just a few examples of what is happening. The problem is not restricted to Camden and Philadelphia, but is harming nearly every school in the Nation.

This Federal admissions tax problem has become so great and aroused so much public interest that literally every board of education in New Jersey has passed a resolution urging elimination of the tax, joining forces with athletic and educational organizations in the State and Nation for its repeal.

Typical comments from educators in New Jersey regarding the tax all express hope that something can be done to eliminate it. Charles W. Mintzer, Fair Lawn High School principal in 1948, pointed out:

It is only a very few of the larger schools, representing a small percentage of the total school enrollment, that show a profit on athletic contests. The smaller schools have enough trouble struggling along even without the tax. Since these affairs are not run for profit, and any money accrued is spent in the interests of the children in furthering their educational program, it seems unfair that any agency should tax these affairs.

P. W. Averill, principal at Thomas Jefferson High School, Elizabeth, N. J., joined the rising protests when he said:

I would like to go on record as one schoolman who feels that if there is to be a reduction in our national tax, this is the first one that should receive consideration. Our games, our dances, and other things connected with the school are not run for personal profit to anyone. They are conducted for the best good of the students in the school and for school morale. Sometimes it is hard enough to carry all these activities and it is much harder when 20 cents of every dollar coming in must go into the Federal Treasury.

Not only have the boards of education been aware of what is happening in the schools because of the tax, but other organizations are alive to its effect and also have urged its elimination. Among them are the National Federation of State High School Athletic Associations, the New Jersey State League of Municipalities, the New Jersey State Interscholastic Athletic Association, and many others.

Even the sports columnists, both nationally prominent and hometown writers, have become aware of the situation and have commented editorially on the detrimental effects of the tax.

Dan Parker, New York Daily Mirror, nationally syndicated writer, recently devoted a lengthy paragraph to the tax, calling it "unfair." He said:

In the tax bill passed by the House recently, the unfair 20 percent tax on high and primary school entertainments and sports events was eliminated, thanks mainly to the campaign being conducted for its repeal by Dr. Ethan Allen Lang, for 10 years president of the board of education in Camden, N. J.

Soon the Senate will act on the tax bill and it is fervently hoped by all who have the interests of American youth at heart that the House's action will be backed up.

In most high schools, the entire program of extracurricular activities is financed by the revenue derived from football and basketball games or school plays or school dances. The amount paid in taxes often means the difference between success and failure for the program aimed at developing healthy outside interests for the children of school age. Surely our Government which can scatter billions around the world will not miss the comparative drop in the bucket that the tax on school athletic meets and entertainment represents. The money thus saved for expanding the program of extracurricular activities is the best investment that America could make for combating juvenile delinquency.

Ed Pollock, sports editor of the Philadelphia Evening Bulletin, is another writer who took the time to show his readers what happens to a percentage of moneys derived from gate receipts at high school sporting events. Mr. Pollock warns that—

At many of the schools, it is feared that a curtailment of athletic programs will be necessary if the tax remains in effect.

Administrators now are making an effort to retain sports which have participation appeal, but draw few if any spectators.

Charlie Schuck, a sports writer for the Camden, N. J., Courier-Post, in a recent sports editorial, expressed a belief elimination of the admissions tax would enable the schools—

to continue present programs on a larger basis and possibly expand to include such sports as golf and larger tenis schedules.

Pointing out that some of the athletic programs are on the "verge of collapse," he wrote that—

athletic directors are looking toward an exemption from the tax as their only ray of hope.

"Bear in mind"—he wrote—

high school athletic programs are strictly nonprofit ventures, designed purely for the development of character in America's youth, to help them learn sportsmanship, gain initiative, and how to become a good loser as well as a good winner.

Mr. Schuck also pointed out that Walter O. Ettinger, principal at Woodrow Wilson High School, Camden, and John McCarthy, athletic director at Camden Catholic High School, agreed:

An end to the tax without a doubt would save many high school athletic programs from complete collapse.

And, in conclusion, allow me to list seven reasons for elimination of the tax as outlined by the National Federation of High School Athletic Associations:

1. The work in collecting the tax and in keeping records adds an undue burden on an already overworked school staff.

2. A large proportion of the tax falls on grade-school and high-school students and this increases the cost of attending school since attendance is usually considered a valuable part of the student's responsibilities.

3. In many cases, the tax is actually assumed by the school and this reduces the funds which are available for maintaining a good activity program.

4. When the tax is added to the price of school event tickets, it tends to discourage attendance and this, in turn, reduces the income for maintaining the school activity program and also reduces the value of the public relations program which is considered vital in most school districts.

5. A tax on an activity tends to reduce interest on the activity. The admissions tax was primarily designed for professional events such as horse racing, boxing, and similar spectacles. The school activity program has little resemblance and relationship to such programs.

6. The grade schools and high schools receive practically no direct returns from Federal appropriations. The taxes are paid in the interests of the school program and used for activities only indirectly related to the schools.

7. Since funds which are secured from school admissions are used to maintain and expand the school program and since the school program is maintained by local taxes, the collection of the admissions tax merely decreases the amount of tax money which is available for administering the school activities.

Gentlemen, I urge you to give full consideration to the facts I have enumerated. Certainly the moneys derived from these school activities represent only a very, very small portion of the over-all tax structure. Yet to the schools, it represents the very lifeblood of the extracurricular program.

It tends to prohibit the school plays which discover the hidden talent and develop ability already established. It discourages the school dances where students of all races, color, and religion mingle on the same social level and it means in some schools the difference between obtaining good shoulder pads or helmets or ones of inferior quality, making the boy wearing it more prone to injury.

In some of the smaller communities, it means the discontinuance of most of the extracurricular activities.

Here is an opportunity to give direct aid to the schools without the accompanying cry of "Federal control."

Gentlemen, I call upon you to retain in your version of this tax bill the provision voted by the House which eliminates the 20-percent Federal tax on school plays, school dances, and athletic contests.

Senator BYRD. Thank you very much, Dr. Lang.

Mr. LANG. Thank you.

Senator BYRD. Mr. John M. Barker.

Will you identify yourself for the record, please?

STATEMENT OF JOHN M. BARKER, MANAGER OF TAXATION, GENERAL MILLS, INC., MINNEAPOLIS, MINN.

Mr. BARKER. I will try to keep within the 10 minutes.

My name is John M. Barker. I am manager of taxation for General Mills, Inc., Minneapolis, Minn.

My purpose in testifying before you is to bring to your attention an inequity in the "base period" under the Excess Profits Tax Act of 1950.

The "base period" as defined in the act and in section 435 (b) of the Internal Revenue Code is the period from January 1, 1946, to December 31, 1949.

One exception is made for certain corporations whose fiscal year ended between January 1 and April 1, 1950. The information that I shall present and the remedy I shall propose concerns only the small number of corporations with fiscal years ending after April 1. These corporations are not treated equitably; they are penalized in computing the base period excess-profits-tax net income as compared to taxpayers on a calendar year or a fiscal year ended before April 1.

When the Excess Profits Tax Act of 1950 was under consideration, it was decided the "base period" should end at March 31, 1950, because corporation income before taxes increased appreciably thereafter. If there should be no favored group permitted a base period beyond March 31, 1950, by the same token there should be no group which suffers a penalty by reason of its income year. Evidently no consideration was given to the fact that corporations whose fiscal year ended after April 1 would be required to include in their base period excess-profits income some months of abnormally low income.

You all are in possession of a copy of my brief. I explain in that brief how a fiscal corporation establishes its base period income. I will skip that.

Senator BYRD. Very well.

Mr. BARKER. Published figures show that corporate income before Federal income tax for 1945 and 1946 varied considerably from quarter to quarter. The rates of corporate profits before taxes will correspond approximately with the excess-profits-tax base period rates of income. I have a table which shows the annual rate of corporation income before Federal income taxes by calendar quarters.

You will note in that table that in the year 1945, in the last two calendar quarters, corporate income was at the rate of $17 billion in the third quarter, and $13.9 billion in the fourth quarter of 1945.

It went up to $15.8 billion in the first quarter of 1946, and then jumped until it got to $30. 5billion at the end of 1946, and it kept going up until in 1948 it reached a high of $36 billion, and then it dropped down again in 1949 and started back up again in 1950.

It should be noted that the rate of profit in the third and fourth quarter of 1945 and in the first quarter of 1946 was exceedingly low as compared with the annual rate of corporate profits after the first quarter of 1946. The rate of profit in these three calendar quarters is, in many instances, less than one-half of the rates of profit in subsequent quarters. Only a corporation whose fiscal year ends after April 1 has to include in the base period earnings for all or a part of the last two quarters of 1945 and all of the earnings of the first quarter of 1946.

While it is true that all corporations are permitted to compute their excess-profits-tax credit by using the best 3 or 4 years, there should, as far as possible, be available to all corporations an equality of choice for the 4-year earnings from which the best 3 years are to be chosen. Only the fiscal year corporation with years ending after April 1 has the penalty of low 1945 earnings in its excess-profits net income for the base period. It also, like other corporations, includes in its base the decline of profits experienced in 1949.

The brief here goes into how many corporations are involved in this. It is not applicable to the point, so I will not recite that.

The corporations whose fiscal year ends after April 1 and whose base periods consequently include a part of the calendar year 1945 are comparatively few in number. In the computation of their excess-profits-tax net income for the base period, they are affected by the following factors which no other corporation needs to consider.

(1) The excess-profits-tax law for World War II applies to 1945 earnings and thus there is taken into account the many economic factors which accompany this type of law and which affect each corporation's earnings differently.

(2) Corporations whose fiscal year ends on April 30, May 31, and June 30, 1946, must deduct from their excess-profits-tax net income for the base period the declared value excess profits tax which was repealed for taxable years ending after June 30, 1469. This tax, according to Treasury figures in Statistics of Income for 1945, part 2, totals over $13 million for this group of corporations.

(3) Earnings in 1945 reflect the economic conditions accompanying the surrender of Germany on May 8, 1945, and the surrender of Japan on September 2, 1945.

(4) The year 1945 reflects the economic results attributable to the cancellation of war contracts following the surrender of Germany and Japan.

(5) Corporate profits before taxes declined materially in 1945 and in the first calendar quarter of 1946. They declined again in 1949. Only the corporations whose fiscal year ends after April 1 take both the 1945 and 1949 declines into their base period.

(6) Only the corporation whose fiscal year ends after April 1 has to include in its excess-profits-tax income for the base period a part of five income years which cover a part of six calendar years.

(7) The economic results of conversion from a war economy to a peace economy affected both 1945 and 1946. These depressing conditions seem to have weighted heaviest in the last two quarters of 1945.

(8) Profits refunded under the Renegotiation Act which expired December 31, 1944, but which was extended by Presidential proclamation to June 30, 1945, must be eliminated from income of the base period. Government contracts and subcontracts thereunder did not again become subject to renegotiation until May 21, 1948.

For these reasons, it is suggested that corporations whose fiscal year ends after March 31, 1950, be permitted at their option to retain the base period provided under the present law or to choose a base period which will cover the period of 48 consecutive months ending on March 31, 1950. An option is suggested because only the corporations whose fiscal year ends after April 1 must use a longer time period in computing their base-period earnings and thus should be permitted a slightly greater leeway of choice. We are not suggesting that the base period be extended beyond March 31, 1950. This is approximately 3 months prior to the beginning of hostilities in Korea.

I will skip the technical amendment included in the statement to do it.

The following corporations join with General Mills, Inc., in respectfully requesting adoption of this suggestion:

Amalgamated Sugar Co., Ogden, Utah; Argus Cameras, Inc., Ann Arbor, Mich.; Chain Belt Co., Milwaukee, Wis.; Cornell-Dubilier Electric Corp., South Plainfield, N. J.; Crown-Zellerbach Corp., San Francisco, Calif.; Cunningham Drug Stores, Inc., Detroit, Mich.; the Dow Chemical Co., Midland, Mich.; the Harshaw Chemical Co., Cleveland, Ohio; King-Seeley Corp., Ann Arbor, Mich.; Nash-Kelvinator Corp., Detroit, Mich.; Omar, Inc., Omaha, Nebr.; Pepperell Manufacturing Co., Boston, Mass.; and the Procter & Gamble Co., Cincinnati, Ohio.

Thank you, gentlemen.

Senator BYRD. Thank you very much, Mr. Barker.

You kept within your time.

(The prepared statement of Mr. Barker is as follows:)

STATEMENT OF JOHN M. BARKER OF GENERAL MILLS, INC., MINNEAPOLIS, MINN.

My name is John M. Barker. I am manager of taxation for General Mills, Inc., Minneapolis, Minn. My purpose in testifying before you is to bring to your attention an inequity in the base period under the Excess Profits Tax Act of 1950. The base period as defined in the act and in Section 435 (b) of the Internal Revenue Code is the period from January 1, 1946, to December 31, 1949. One exception is made for certain corporations whose fiscal year ended before April 1 in 1950. The base period for these corporations is the 48 consecutive months ending with the close of the fiscal year which ended between January 1, and April 1, in 1950. The information that I shall present and the remedy I shall propose concerns only the small number of corporations with fiscal years ending after April 1. These corporations are not treated equitably; they are penalized in computing the base-period excess-profits-tax net income as compared to taxpayers on a calendar year or a fiscal year ended before April 1.

When the Excess Profits Tax Act of 1950 was under consideration, it was decided the base period should end at March 31, 1950, because corporation income before taxes increased appreciably thereafter. If there should be no favored group permitted a base period beyond March 31, 1950, by the same token there should be no group which suffers a penalty by reason of its income year. Evidently no consideration was given to the fact that corporations whose fiscal year ended after April 1 would be required to include in their base-period excess-profits income some months of abnormally low income.

The corporation with a fiscal year which ends after April 1, 1950, must establish its excess-profits net income for the base period in a manner different from all other corporations. To illustrate the method by which these corporations must reconstruct income for the calendar years 1946 to 1949, let us consider a corporation with a fiscal year ending June 30. The corporation must first start with the income for the five income years:

July 1, 1945, to June 30, 1946
July 1, 1946, to June 30, 1947
July 1, 1947, to June 30, 1948
July 1, 1948, to June 30, 1949
July 1, 1949, to June 30, 1950

The income for each of the 5 years is divided by 12 to obtain an income per month. The income per month for each of these income years is considered to be earned in the respective months of the income years which are in the calendar years 1946 to 1949. For instance, the year 1946 of the base period consists of

6 months of the earnings from the income year July 1, 1945, to June 30, 1946, and 6 months of earnings from the income year July 1, 1946, to June 30, 1947.

Published figures show that corporate income before Federal income tax for 1945 and 1946 varied considerably from quarter to quarter. The rates of corporate profits before taxes will correspond approximately with the excess-profits-tax base-period rates of income. I have a table which shows the annual rate of corporation income before Federal income taxes by calendar quarters.

Annual Rates of Corporate Profits Before Taxes [1]

[Billions of Dollars]

Calendar quarters	1945	1946	1947	1948	1949	1950
First quarter	24.0	15.8	31.4	33.0	28.3	29.2
Second quarter	24.0	21.6	30.9	35.0	26.4	37.4
Third qurter	17.0	26.4	31.3	36.6	28.2	46.4
Fourth quarter	13.9	30.5	32.8	34.5	27.6	50.8

[1] Sources: 1945-49 Statistical Supplement, Survey of Current Business, Department of Commerce, 1949; 1950 Economic Indicators, June 1951.

It should be noted that the rate of profit in the third and fourth quarter of 1945 and in the first quarter of 1946 was exceedingly low as compared with the annual rate of corporate profits after the first quarter of 1946. The rate of profit in these three calendar quarters is, in many instances, less than one-half of the rates of profit in subsequent quarters. Only a corporation whose fiscal year ends after April 1 has to include in the base period earnings for all or a part of the last two quarters of 1945 and all of the earnings of the first quarter of 1946. While it is true that all corporations are permitted to compute their excess-profits-tax credit by using the best 3 of 4 years, there should, as far as possible, be available to all corporations an equality of choice for the 4-year earnings from which the best 3 years are to be chosen. Only the fiscal year corporation with years ending after April 1 has the penalty of low 1945 earnings in its excess-profits net income for the base period. It also, like other corporations, includes in its base the decline of profits experienced in 1949.

The Statistics of Income for 1945, part 2, the latest publication by the Treasury Department shows that 303,019 corporations reported income for 1945. Of these corporations 60,307 had fiscal years which ended March 31. This is approximately 20 percent of the total. The same publication indicates 52,097 corporations filed excess-profits-tax returns which showed an excess-profits-tax liability and that 16,266 of these used the income method to determine their excess-profits-tax credit. I would estimate there are about 3,250 corporations involved in this base period problem if the percentage of corporations whose fiscal year ends after March 31 is applicable to the corporations who use the income method to determine excess-profits-tax credit.

The corporations whose fiscal year ends after April 1 and whose base periods consequently include a part of the calendar year 1945 are comparatively few in number. In the computation of their excess-profits-tax net income for the base period, they are affected by the following factors which no other corporation needs to consider.

(1) The excess profits tax law for World War II applies to 1945 earnings and thus there is taken into account the many economic factors which accompany this type of law and which affect each corporation's earnings differently.

(2) Corporations whose fiscal year ends on April 30, May 31, and June 30, 1946, must deduct from their excess-profits-tax net income for the base period the declared value excess-profits tax which was repealed for taxable years ending after June 30, 1946. This tax, according to Treasury figures in Statistics of Income for 1945, part 2, totals over $13 million for this group of corporations.

(3) Earnings in 1945 reflect the economic conditions accompanying the surrender of Germany on May 8, 1945, and the surrender of Japan on September 2, 1945.

(4) The year 1945 reflects the economic results attributable to the cancellation of war contracts following the surrender of Germany and Japan.

(5) Corporate profits before taxes declined materially in 1945 and in the first calendar quarter of 1946. They declined again in 1949. Only the

corporations whose fiscal year ends after April 1 take both the 1945 and 1949 declines into their base period.

(6) Only the corporation whose fiscal year ends after April 1 has to include in its excess-profits-tax income for the base period a part of five income years which cover a part of six calendar years.

(7) The economic results of conversion from a war economy to a peace economy affected both 1945 and 1946. These depressing conditions seem to have weighted heaviest in the last two quarters of 1945.

(8) Profits refunded under the Renegotiation Act which expired December 31, 1944, but which was extended by Presidential proclamation to June 30, 1945, must be eliminated from income of the base period. Government contracts and subcontracts thereunder did not again become subject to renegotiation until May 21, 1948.

For these reasons, it is suggested that corporations whose fiscal year ends after March 31, 1950, be permitted at their option to retain the base period provided under the present law or to choose a base period which will cover the period of 48 consecutive months ending on March 31, 1950. An option is suggested because only the corporations whose fiscal year ends after April 1 must use a longer time period in computing their base-period earnings and thus should be permitted a slightly greater leeway of choice. We are not suggesting that the base period be extended beyond March 31, 1950. This is approximately 3 months prior to the beginning of hostilities in Korea.

To accomplish this suggestion, we propose that section 435 (b) of the Internal Revenue Code be amended to read as follows (italicized portion added to present statute):

"(b) BASE PERIOD.—As used in this subchapter the term 'base period' means the period beginning January 1, 1946, and ending December 31, 1949, except that in the case of a taxpayer whose first taxable year under this subchapter was preceded by a taxable year which ended after December 31, 1949, and before April 1, 1950, and which began before January 1, 1950, the term 'base period' means the period of 48 consecutive months ending with the close of such preceding taxable year", *or in the case of a taxpayer whose first taxable year under this subchapter was preceded by or includes a taxable year which began before January 1, 1950, and ended after March 31, 1950, the term "base period" at the option of the taxpayer means the period of 48 consecutive months ending with March 31, 1950.*

The following corporations join with General Mills, Inc., in respectfully requesting adoption of this suggestion.

Amalgamated Sugar Co., Ogden, Utah
Chain Belt Co., Milwaukee, Wis.
Crown Zellerbach Corp., San Francisco, Calif.
The Dow Chemical Co., Midland, Mich.
King-Seeley Corp., Ann Arbor, Mich.
Omar, Inc., Omaha, Nebr.
The Procter & Gamble Co., Cincinnati, Ohio
Argus Cameras, Inc., Ann Arbor, Mich.
Cornell-Dubilier Electric Corp., South Plainfield, N. J.
Cunningham Drug Stores, Inc., Detroit, Mich.
The Harshaw Chemical Co., Cleveland, Ohio
Nash-Kelvinator Corp., Detroit, Mich.
Pepperell Manufacturing Co., Boston, Mass.

Senator BYRD. Mr. Boeschenstein.

Senator KERR. Mr. Chairman, I am sure the committee is aware of the fact that Mr. Boeschenstein was one of the men who came up during World War II and devoted most of his time to an important assignment in the War Production Board.

Mr. BOESCHENSTEIN. Thank you, sir.

Senator BYRD. Will you identify yourself for the record?

STATEMENT OF HAROLD BOESCHENSTEIN, PRESIDENT, OWENS-CORNING FIBERGLAS CORP.

Mr. BOESCHENSTEIN. My name is Harold Boeschenstein. My address is the Nicholas Building, Toledo, Ohio.

I am president of the Owens-Corning Fiberglas Corp., which is the pioneer in the development of and leading manufacturer of glass in fibrous forms. Our company competes in building, industrial, transportation, and domestic appliance insulation and in the synthetic textile yarn fields.

I appreciate the opportunity to appear before your committee to petition immediate action by the Congress in the Revenue Act of 1951 to alleviate the unfairness of the 1950 Excess Profits Tax Act as applied to the Owens-Corning Fiberglas Corp.

We are filing a prepared statement and brief, Mr. Chairman; so as to conserve the committee's time, I will cover only the high spots here.

Senator BYRD. You are assigned 10 minutes.

Mr. BOESCHENSTEIN. Without additional relief my company will not only pay excess-profits taxes on all earnings attributable to the defense program, but on 50 percent of our normal peacetime earnings as well.

This unfair taxation of normal profits comes about because our excess-profits-tax credit under the most favorable of the relief provisions will be only $6 million, although our normal level of earnings at the end of the base period was $12 million per annum.

This wide discrepancy between our excess-profits-tax credit and our normal earnings level results because the present act does not give adequate recognition to extraordinary growth.

During the base period, 1946 to 1949, we quadrupled our investment in plant, doubled our productive capacity, doubled our sales, and increased our earnings more than tenfold.

I submit, gentlemen, that this is a record of extraordinary growth.

The Korean War and accelerated defense needs had nothing whatever to do with these facts.

During 1946 to 1950, our growth in plant was twice that of our eight principal competitors and 3 times that of manufacturing corporations in general. Our increase in sales was 2½ times those of all manufacturing corporations.

But, after taxes, we were permitted to keep, in 1950, 18 percent less of our net income than the average for all manufacturers.

As the impact of the excess-profits tax increases in 1951 and subsequent years, this spread will become even greater.

We do not believe that the members of this committee and Congress intend to place a growing and expanding corporation at such a serious competitive disadvantage. Indeed, your chairman said on the floor in closing the debate on the bill:

> Whether the new relief formulas will adequately meet these situations, of course, the committee cannot say. We only express the hope that they will.

My statement is designed to show that the relief formulas provided fail to meet adequately our situation; that such relief can be provided without changing the policy and purview of the existing law or subjecting the Treasury to substantial losses of anticipated revenue.

Owens-Corning Fiberglas Corp. was organized in November 1938. We were pioneers in the development of glass in fibrous forms.

With an entirely new basic material and no developed and few known applications and uses, we had been in existence barely 2 years when the World War II preparedness program began.

To meet military needs and make the maxmum contribution to the war effort, we abandoned our civilian products and converted almost entirely to war materials.

As a result, we lost most of our newly created markets and newly found customers.

Throughout the war period, more than 90 percent of our production was for war purposes, a great proportion of which had no carry-over into civilian markets.

Senator MILLIKIN. What are the peculiar properties of Fiberglas?

Mr. BOESCHENSTEIN. The peculiar properties of Fiberglas, Senator, that made it valuable in war are its strength in relation to weight, its inorganic qualities, which mean that it will not rot and will not deteriorate, and its fire safety, because it will not burn.

We submit as exhibit 1 an account of the war production record of the Fiberglas Corp. in World War II. I think that will give you the details, sir.

What we did in World War II is the root source of our troubles today under the excess-profits-tax law as it exists.

When VJ-day came and our war contracts were canceled, our production facilities were completely out of balance with our civilian markets. We had expanded our production of textile fibers more than 700 percent to meet requirements of the Armed Forces for specialized products which had no counterpart in civilian markets.

On the one hand, we had a potential demand for insulation greatly in excess of the capacity of our one wool plant, and, on the other, we had two war-created plants equipped to produce textile fibers, for which civilian demands were entirely undeveloped.

To meet the crisis which faced us, we turned all of our energies and resources to the construction of facilities to meet the rapidly expanding insulation needs, and during the years 1946 through 1949 we constructed two new plants and reconverted and rehabilitated three existing plants at a cost of more than $23 million, which was a lot for a small business.

We also instituted vigorous research and sales programs to develop markets which would absorb the excessive capacity of our textile fiber facilities.

It was not until the last quarter of 1949 that the fruits of this broad expansion and development program began to be realized to any substantial degree.

During each year from 1946 through 1949, our profits were seriously depressed by our program for expanding our facilities for insulation and developing markets to utilize excess facilities that we had for Fiberglas textiles.

By the end of 1949, however, the development of new markets indicated that for the first time since World War II our textile capacity could be maintained at a profitable level of operation. This came about through the development of new markets.

The expansion program, more than doubling our facilities, was nearly finished. Sales for the first half of 1950 were greater than for the entire year of 1946.

Senator KERR. Right there, Mr. Boeschenstein, that was sales in the domestic markets?

Mr. BOESCHENSTEIN. Entirely, sir.

Senator KERR. And not in any way connected with war production or the preparation for war?

Mr. BOESCHENSTEIN. That is right. Our sales, or, rather, our profits for the 6 months were $6,000,000, compared with less than $1,000,000 for each of the years 1946 and 1947. This potential level of income of $12,000,000 at the end of 1949 was in no way related to the war. Those were normal, developed earnings.

We have prepared exhibit 2 showing this growth in plant, sales, and earnings in tabular form, for your convenience.

The provisions of the present law do not recognize this tremendous growth.

I will not attempt to go into details of the inadequacies of the present provisions, because time does not permit, and, also, these are technical, detailed, legal problems.

Senator MILLIKIN. Is your corporation a subsidiary of the Owens-Illinois Glass Co.?

Mr. BOESCHENSTEIN. No. It is not a subsidiary of any company, sir.

The Owens-Illinois Co. has an investment in it, but it is a minority investment.

I am not qualified to get too deep into technical legal problems, but I can only say that the provisions of the act are entirely inequitable, applied to our situation. They are discussed in a memorandum which is exhibit 3.

You may ask, Why is the present act so unfair that it should be remedied now?

First, it subjects to excess-profits tax not a relatively minor fraction of our normal profits, but roughly half of our normal profits.

Second, by subjecting 50 percent of our normal profits to excess-profits tax, we will be seriously restricted in our efforts to maintain our research and expand the production of our products necessary to defense and to maintain competitive civilian production.

The market for glass fibers is expanding dramatically. At present we are supplying approximately 100 important products to the defense program.

Essential civilian needs are also straining our present capacity.

Incidentally, this situation has been worsened by the recent flood in Kansas City, which has caused severe damage and serious loss of production in one of our principal plants.

Senator KERR. What area was your plant in?

Mr. BOESCHENSTEIN. We were in the Fairfax district. We have 9½ feet of water in our plant. They thought those dikes were impregnable in that area. It did not work out that way.

Third, we will be unable to compete on equal terms with much older and well-established companies in our respective fields. And that is a very important matter to us.

In 1950, one of the largest companies in the insulation field had only 20 percent of its income subject to excess-profits tax. Another principal competitor in textiles had only 28 percent subject to excess-profits tax.

In contrast, we had 62½ percent subject to excess-profits tax.

I would like to emphasize that very strongly, gentlemen, because the crux of it is in there. Over a period of years you cannot remain competitive under those circumstances.

Our case is unusual but certainly not unique. A credit could be provided by a specific growth formula similar to that now applicable to the new product corporation. No valid reason is apparent for providing a growth formula in the one situation and not in the other.

For example, a formula which would grant the corporation experiencing extraordinary growth the same type of relief as is now afforded a new products corporation might require that the taxpayer establish the fact of that type of growth by meeting tests which are set forth on page 10 of my statement, which I will not go into.

If the taxpayer could show this requisite growth in sales, plant, and income, its credit would be based on the level of its business at the end of the base period, and prior to any influence of the Korean War or the abnormal defense program.

I have, of course, oversimplified the corrective formula for purposes of my statement. When one attempts to propose a specific statutory provision, one must choose between technical alternatives.

However, to illustrate the type of provisions, we are submitting two proposals. This is quite technical for me, but I would like to read these proposals which are very brief. I know you gentlemen will understand them a great deal more readily than I have, and you can evaluate them for yourselves.

Proposal A would allow a credit based upon the assets actually employed in the business during the last half of 1949 and the first half of 1950, and the rate of return realized during the first half of 1950.

Proposal B would allow a credit based upon the earnings for the first half of 1950 or the weighted excess-profits net income for the first taxable year.

I am offering these two proposals as exhibits 5 and 6 for your consideration and convenience.

An alternative to such a growth formula would be the reenactment of the general relief provisions similar to section 722 of the World War II excess-profits tax.

But I would hope, gentlemen, that the administrative difficulties, which have greatly delayed and confused the disposition of cases under that section, might be alleviated if such a provision were made, by statutory standards specifying qualifications for relief and for measuring the scope of relief; in other words, limit the area of discretion in the administration.

Thank you very much.

Senator BYRD. Thank you, Mr. Boeschenstein. You made a fine statement.

Mr. BOESCHENSTEIN. Thank you.

(The prepared material is as follows:)

STATEMENT OF HAROLD BOESCHENSTEIN, PRESIDENT OF OWENS-CORNING FIBERGLAS CORP.

My name is Harold Boeschenstein. My address is the Nicholas Building, Toledo, Ohio. I am president of the Owens-Corning Fiberglas Corp., which is the pioneer in the development of and leading manufacturer of glass in fibrous forms.

Our company competes in building, industrial, transportation, and domestic appliance insulation and in the synthetic-textile-yarn fields.

I appreciate the opportunity to appear before your committee to petition action by the Congress in the Revenue Act of 1951 to alleviate the unfairness of the 1950 Excess Profits Tax Act as applied to the Owens-Corning Fiberglas Corp.

Without additional relief over and above that provided in the present Excess Profits Tax Act, my company will not only pay excess-profits taxes on all earnings attributable to the defense program, but on 50 percent of our normal peacetime earnings, as well. My company is being deprived of profits which have resulted from research and product development leading to growth in sales and productive capacity accomplished prior to, and which had no relation to, the Korean outbreak.

This unfar taxation of normal profits comes about because our excess-profits-tax credit under the most favorable of the relief provisions will be only $6,000,000, although our normal level of earnings at the end of the base period was $12,000,000 per annum.

This wide discrepancy between our excess-profits-tax credit and our normal-earnings level results because the present act does not give adequate recognition to extraordinary growth.

During the base period, 1946–49, we—

Quadrupled our investment in plant.

Doubled our productive capacity.

Doubled our sales.

Increased our earnings more than tenfold.

During 1946 to 1950 our growth in plant was twice that of our eight principal competitors; three times that of manufacturing corporations in general. Our increase in sales was 1½ times that of our eight principal competitors; 2½ times that of all manufacturing corporations. Our increase in net income was 7 times that of our eight principal competitors, and 10 times that of all manufacturing corporations. After taxes, however, we were permitted to keep in 1950 18 percent less of our net income than all manufacturing corporations, and 8 percent less than our eight principal competitors. As the bite of the excess-profits tax increases in 1951 and subsequent years, this spread will become even greater.

This discrimination against us is solely because the present act does not take into account extraordinary growth, so that our excess-profits-tax credit does not reflect the stature we had attained upon the completion of our major expansion program some 6 months prior to the Korean outbreak. We do not believe that the members of this committee and Congress intended to place a growing and expanding corporation at such a serious competitive disadvantage and subject its normal peacetime earnings to an excessive and discriminatory tax. Indeed, officials of the company realize that in the time available preceding the enactment of the present law this committee and Congress sought earnestly to provide adequate relief for corporations experiencing this type of extraordinary growth. Your chairman said on the floor in the closing debate on the bill:

"Whether these formulas (the new relief formulas) will adequately meet these situations, of course the committee cannot say. We only express the hope that they will * * *."

My statement is designed to show that the relief formulas provided fail to meet adequately our situation, that the resulting unfairness to taxpayers in our situation is so substantial as to require legislative relief, and that such relief can be provided without changing the policy and purview of the existing law or subjecting the Treasury to substantial losses of anticipated revenue.

HISTORY OF FIBERGLAS' EXTRAORDINARY GROWTH

Owens-Corning Fiberglas Corp. was organized in 1938. We were pioneers in the development of glass in fibrous forms. We were just becoming established when the World War II preparedness program began. To meet military needs and make the maximum contribution to the war effort we abandoned our civilian products and converted almost entirely to war materials. As a result, we lost most of our newly created markets and newly found customers. Our extensive research projects designed to develop civilian uses for Fiberglas products were shelved for the duration and our research efforts were shifted to the development of materials for war. Throughout the entire war period more than 90 percent of our production was for war purposes, a great proportion of which had no carry-over into civilian markets. We submit as exhibit 1 an account of the war-production record of the Fiberglas Corp. in World War II because what we did in World War II is the root source of our troubles today under the excess-profits-tax law.

When V-day came and our war contracts were canceled, our production facilities were completely out of balance with our civilian markets. We had expanded our production of textile fibers more than 700 percent to meet requirements of the Armed Forces for specialized products which had no counterpart in civilian markets. Glass textiles, which amounted to only a very small percent of our production in the prewar period skyrocketed to 60 percent of our production throughout the war. In the postwar economy textiles fell abruptly to 20 percent of our production. The year 1946 found our company with a potential demand for insulation greatly in excess of the capacity of our one wool plant, on the one hand, but with two war-created plants equipped to produce textile fibers for which civilian demand was undeveloped—except to a limited extent in the electrical-insulation field—on the other hand. Moreover, large Government surpluses of Fiberglas textiles more than saturated this meager Fiberglas-textile market.

To meet the crisis which faced us, we turned all of our energies and resources to the construction of facilities to meet the rapidly expanding needs for house, transportation, and appliance insulation and corrosive protective mats, and to build up our technology and our market position in these fields. During the years 1946 to 1949, we constructed two new plants and reconverted and rehabilitated three existing plants, at a cost of more than $23,000,000.

We also instituted vigorous research and sales programs to develop markets which would absorb the capacity of our textile-fiber facilities. For the 4 years immediately following the war our textile capacity was four times our average textile sales. It was not until the last quarter of 1949 that the fruits of this broad expansion and development program began to be realized to any substantial degree. During each year from 1946 through 1949 our profits were seriously depressed by our program for both expanding our facilities for insulation production and developing markets for Fiberglas textiles.

By the end of 1949, however, the gradual and costly development of new textile markets indicated that for the first time since World War II our textile capacity could be maintained at a profitable level of operation. The expansion program to provide additional insulation capacity was nearly finished. Facilities having a production potential of more than $100,000,000 had been completed. Our maximum production potential at the beginning of the base period was less than half this amount.

Sales for the first 6 months of 1950 were $34,000,000, compared with $33,000,000 for the entire year of 1946. Our earnings for the 6 months were $6,000,000, compared with less than $1,000,000 for each of the years 1946 and 1947. This potential annual level of income of $12,000,000 at the end of 1949 was in no way related to the war. These were normal 1950 earnings.

We have prepared an exhibit showing this growth in plant, sales, and earnings in tabular form, and I would like to offer it as exhibit No. 2.

THE PRESENT LAW DOES NOT GIVE ADEQUATE RECOGNITION TO OUR EXTRAORDINARY GROWTH

The provisions of the present law do not recognize this tremendous growth.

The earnings credit is based primarily upon the average net income of our three best base-period years. But not one of these years was normal in our case. During the entire base period our income was greatly depressed by the many problems connected with developing, building, and getting new plants into operation and in developing acceptable textile products and new markets. Any credit which assumes that our base-period income was normal will be entirely inadequate.

The present growth formula comes the nearest to recognizing our problem, for it provides that 40 percent of 1950 earnings shall make up one-half of the excess-profits-tax credit. But the growth formula is probably inapplicable in our case. It requires that 40 percent of net sales in 1950 must be from new products. Furthermore, even if it were applicable, it would not provide an adequate measure of relief. As in the case of the earnings credit it assumes that 1949 was a normal year, and bases one-half of the credit upon it.

The present law also contains three relief provisions under one or more of which we undoubtedly qualify. These are the provisions relating to abnormalities during the base period, increase in capacity, and changes in products. But all of these have the same common fault. They allow in computing the credit a rate of return which is the average for the many heterogeneous businesses making up the stone, clay, and glass industry, a return of only 16.5 percent before taxes. Such a return is entirely unrealistic for a dynamic corporation such as ours, pioneering with a new product, and creating broad new markets and demands in many fields.

I will not attempt to go into the details of the inadequacies of these provisions because time does not permit, and also because these are technical legal problems. They are discussed, however, in a memorandum, which we have prepared on the subject matter covered by my statement. I would like to offer a copy of the memorandum as exhibit No. 3, and refer you to it for a discussion of the inadequacy of the various provisions of the present law in our situation.

THE FAILURE TO GIVE ADEQUATE RECOGNITION TO GROWTH RESULTS IN UNFAIR TAXATION OF OUR NORMAL PROFITS

Why is the present act so unfair that it should be remedied now?

First, it subjects to excess-profits tax not a relatively minor fraction of our normal profits, but roughly half of our normal profits.

The new level of earnings which we reached during the first 6 months of 1950 resulted from the expenditure of $23,000,000 in plant expansion during the base period, almost three times our existing investment in plant—and the plowing back of base-period earnings into research, market development, and personnel training. Our new profits at a rate of $12,000,000 per annum for the first 6 months of 1950 were not war profits, but the result of carefully planned expansion.

Second, by subjecting 50 percent of our normal profits to excess-profits tax, we will be seriously restricted in our efforts to maintain our research and expand the production of our products so necessary to defense and essential civilian production.

The market for glass fibers is expanding dramatically. We are at present supplying approximately 100 important products to the defense program. Essential civilian needs are also straining our present capacity to the utmost. We need every available dollar for further development. The situation has been made more critical by the recent flood in Kansas City which has closed down one of our principal plants and caused damage to it estimated in excess of $2 million.

Third, we will be unable to compete on equal terms with much older and well-established companies in our respective fields.

I think members of this committee would be interested in knowing how the inequity under which we suffer under this law compares with the happier fortune of our older and better-established competitors who expanded at a far lesser rate than we did during the base period.

One of our principal competitors in the insulation field has a credit equal to 80 percent of its 1950 income, leaving only 20 percent subjected to excess-profits tax.

Another principal competitor in our other major market, i. e., textiles, has a credit of 72 percent of its 1950 income, leaving only 28 percent subject to excess-profits tax.

Contrast these examples with our case. Our credit will be only 37½ percent of our 1950 income, leaving 62½ percent subject to excess-profits tax.

PROPOSED ADDITIONAL RELIEF PROVISIONS

Our case is unusual, but certainly not unique. There will be other coprorations which have enjoyed extraordinary growth and reached a new level of sales and income at December 31, 1949. Such corporations are not protected by the relief provisions of the 1950 act. They should be entitled to a credit reflecting the new level of growth attained at the end of the base period.

Such a credit could be provided by a specific growth formula similar to that now applicable to the new-product corporation. No valid reason is apparent for providing a growth formula in the one situation and not in the other.

For example, a formula which would grant the corporation experiencing extraordinary growth the same type of relief as is now afforded the new-product corporation is as follows:

Tests.—The taxpayer would establish the fact of extraordinary growth by showing—

1. That its sales for the first half of 1950 were 50 percent or more above the level of 1946 and 1947;
2. That either its plant facilities or productive capacity had increased 100 percent during the base period, or that both had increased by 50 percent; and
3. That its level of income for the first half of 1950 was, say, 100 percent or 200 percent in excess of its average base-period income.

Credit.—If the taxpayer could show this growth in sales, plant, and income, its credit would be based on the level of its business at the end of the base period.

This formula is based on tests similar to those already adopted, and could be made effective by simple amendments to section 435.

Under such a formula our credit would be between $10,000,000 and $11,000,000; rather than $6,000,000—a credit more nearly commensurate with our normal peacetime-earnings level of $12,000,000. It would still leave $5,000,000 to $6,000,000 of our 1950 earnings—roughly one-third—subject to excess-profits taxes.

I have, of course, oversimplified the corrective formula for purposes of my statement. When one attempts to propose a specific statutory provision, one must choose between various technical alternative approaches, which may have varying degrees of acceptability to this committee, its technical advisers or others concerned. We want to make it clear that we are not wedded to any particular drafting approach so long as the corrective provision adjusts our situation fairly and adequately. However, to illustrate the type of provisions which, in our judgment, would suffice we are submitting two proposals:

(*a*) Proposal A which would allow a credit based upon the assets actually employed in the business during the last half of 1949 and the first half of 1950, and the rate of return realized during the first half of 1950.

(*b*) Proposal B which would allow a credit based upon the earnings for the first half of 1950 or the "weighted excess profits net income" for the first taxable year.

Proposal A would seem to be nearer to the present growth formula for the "new product" corporation, but proposal B is simpler.

Other proposals may be developed that would accomplish the desired result and would be more preferable from other viewpoints. The important thing is that the act be amended so that the taxpayer experiencing extraordinary growth in its business is not taxed oppressively on its normal profits.

I am offering our two proposals as exhibits. Exhibit 4 is our proposal A. Exhibit 5 is our proposal B.

GENERAL RELIEF PROVISION

An alternative to such a growth formula, if Congress should decide not to enact further specific relief provisions, would be the reenactment of a general relief provision similar to section 722 of the World War II excess-profits tax.

To eliminate the administrative difficulties which have greatly delayed the disposition of cases under that section, however, there should be written into the law statutory standards for qualification for relief and for measuring the scope of the relief to be allowed, similar to those of the proposed formula for extraordinary growth.

In the case of growing corporations, for example, the statutory standards for qualifications should include substantial growth in sales, plant facilities, and net income. Any taxpayer meeting all of these high standards should qualify for relief, at least presumptively. Administrators of the law would also be guided by these standards in granting relief to other taxpayers not able to meet them all.

Taxpayers evidencing extraordinary growth by meeting all the standards prescribed in the formula should be allowed a reasonable minimum reconstruction of normal earnings.

Such standards for qualification and for reconstruction should eliminate to a very great extent the administrative difficulties encountered under section 722.

EXHIBIT 1

WAR PRODUCTION RECORD OF FIBERGLAS CORP. IN WORLD WAR II

In realization of the close relationship of Fiberglas products to the war effort, Mr. Boeschenstein, at the November 27, 1940, meeting of the board of directors, proposed that the company's policy be to give priority to Government requirements for defense purposes and to provide at its own risk, insofar as possible, and as could then be foreseen, such manufacturing and storage facilities as might be needed to produce and supply insulation for combat ships. The board expressed its accord with that policy.

After the United States entered the war, Fiberglas products increasingly were engineered into war production applications, and at the height of the war some 93 percent of the corporation's production was being supplied for war purposes. (1945 annual report.)

The manufacture of fibrous glass was listed as an essential activity under items 20 and 22 of the War Manpower Commission release of March 25, 1943, and subsequent lists. Further, Conservation Order M-282, dated February 9, 1943, listed fibrous glass textiles as critical materials and required that they be allocated to claimant agencies by the War Production Board for approved end uses. At the end of the war these materials were still under allocation in accordance with WPB Scheduling Order M-293 of April 1, 1944.

The versatility and adaptability of Fiberglas products led to their use on a large scale by all branches of the Armed Forces. In all applications of military interest some combination of properties inherent in Fiberglas products provided characteristics that no other available material could offer to the same degree, or, a Fiberglas product was utilized to take the place of some material in short supply. High strength-weight ratio, low moisture pick-up and noninflammability were among the former. Use of Fiberglas cloth in place of aluminum to face hull insulation was an instance of the latter.

Fiberglas insulating wool, formerly used in domestic equipment and buildings, was diverted to newly fabricated forms—for bomber plant insulation and insulating board for combat and cargo vessels. Fiberglas yarns were diverted to such uses as parachute flare shades, wing liners for aircraft and reinforcement for plastic laminates. The added advantages of Fiberglas electrical insulation were of even greater value in their military applications.

Fiberglas became an essential component of military aircraft in some 96 applications, including electrical insulation for small motors, insulation of radio hook-up wire, aircraft ignition harnesses, insulation blankets, wing liners, and fuel cell covering.

By 1945, products available had increased to more than 100, supplied in some 5,000 variations of dimension, fabrication, packaging or density (1945 annual report).

WOOL PRODUCTS

Ship insulation

One of the most important properties required of materials used in the construction of United States naval ships is incombustibility, or fire safety. With respect to insulating materials, this requirement was met by Fiberglas.

As early as 1932, shortly after the first Fiberglas thermal insulation was produced, it was installed on horizontal surfaces in several Navy ships. The insulation performed so efficiently that it was adopted for all horizontal surfaces in living quarters and magazines, and for all refrigerator spaces, in all fighting craft designed after 1935. In 1939 the Navy adopted glass fiber material as thermal insulation throughout all its fighting ships.

When, after the United States entered the war, it became necessary to conserve aluminum and other lightweight materials, the Navy Department and the Fiberglas Corp. worked together to develop a glass fiber board faced with Fiberglas cloth which was used for both thermal insulation and interior finish on the Navy's fighting ships.

While the Navy was increasing its use of Fiberglas insulation, the same material was adopted by the merchant marine, and within 6 months after the United States declared war on the Axis Powers, 75 shipyards were using Fiberglas to insulate living quarters, refrigerated spaces, magazines, bulkheads, pipes, ventilating ducts, casings, and boiler uptakes.

Cloth-faced Navy board, in point of quantity, was the chief contribution of Fiberglas to the war effort. It was in reality a combination of two developments. The use of 9-pound density Fiberglas insulating wool, preformed for ready cutting and fitting in and about the hull of a ship, not only enabled the construction of military ships to be speeded immeasurably but greatly increased their capacity for stores and their cruising radii. The use of Fiberglas cloth as a facing for the hull insulation released great quantities of aluminum for other uses at a time when aluminum was in short supply: 180,301,100 square feet of hull insulation went to shipbuilders during the war. In popular terms this amount would cover a highway 20 feet wide from Boston to Kansas City, a distance of 1,420 miles, or fill a train of box cars 45 miles long—20,033,455 yards of glass cloth was used to surface the hull insulation. In addition to the foregoing, 112,234,000 square feet of Fiberglas thermal insulation in varying densities were supplied for use on shipboard; 224,780,584 feet of stripping and lagging tape were needed to finish the application, and 4,734,931 yards of lagging cloth were used to wrap insulated pipes. Twenty-five tons of glass thread were used to sew the lagging cloth (1945 annual report).

Superfine fiber

The superfine fiber was another product development of the war years. It became of importance to the Navy as a flotation filler which proved superior to kapok. During 1945 a program was developed which included building and equipping two plants in the Kansas City area. The Army Air Forces made available the North American Modification Center in Kansas City, Kans., and the surplus plant of the Aluminum Corp. of America, in Kansas City, Mo., was acquired.

Working as a team on this urgent program, the Navy, the War Production Board, the Reconstruction Finance Corporation, and Fiberglas overcame many problems. The Navy entered into a supply contract with Owens-Corning Fiberglas Corp. to produce the fibrous glass, the War Production Board placed the project near the top of its special military programs, machinery and equipment orders were placed and expedited, and the program was under way to produce a supply of buoyant material in sufficient volume to satisfy all Navy requirements for use in life preservers, commencing in January of 1946.

In a letter of July 17, 1945, from Acting Secretary of the Navy Hensel to Director John W. Snyder of the Reconstruction Finance Corporation, the Navy's need for Fiberglas "A" fiber, to serve as filler for life preservers and invasion jackets, was declared to be critical. And it was urged that the Reconstruction Finance Corporation should waive a technical objection to the proposal in view of the extreme urgency of the program.

When the war with Japan came to a successful conclusion in August of 1945, the Navy and the Reconstruction Finance Corporation moved immediately to cancel out this program, but with the understanding that Fiberglas would arrange to produce "A" type fibrous glass commercially for the Navy without Government facilities or financing.

This new material had already demonstrated its superiority over kapok because it was fire and mildew proof, had superior buoyancy qualities, could withstand repeated wetting and drying with little loss in efficiency and could be produced domestically in uniform quality without dependence of any nature upon far-removed and uncertain sources of supply. Thus through prior provision for the emergency by accumulation of a stockpile before the war and through careful planning and conservation, our kapok stocks served the Navy and other military claimants throughout World War II while other available materials were being investigated and tested until, born out of necessity, a new synthetic material was developed which proved so superior to the traditional kapok that now it has been adopted by the Navy as the standard of quality for buoyant material to be used in life preservers.[1]

Aircraft

Superfine or "A" fibers also were fabricated into blankets and used for thermal and acoustical insulation in military aircraft. The use of this product resulted in substantial savings of space and weight, and the insulation did not decompose under tropical conditions. Prior to VJ-day 6,550,463 square feet of this material were supplied for use in military planes.

XM-PF

Before the development of the "A" fiber, the need for a light-weight, form-retaining insulation was met by Fiberglas XM-PF insulation. This product had high sound-deadening properties for its weight and desirable form retaining characteristics. Of particular note is the fact that the material was fabricated from textile fibers remaining from other fabricating operations. Thus large quantities were made available with relatively small plant expansion: 13,523,203 square feet were supplied for military aircraft.

When available plant space at Newark proved inadequate for this operation, the corporation developed and placed in operation machinery for its production at the Kansas City plant of the Gustin-Bacon Co.

AE Board

AE or asphalt enclosed board was another important wartime product development. It consisted of high density PF wool covered with asphalt on all sides. AE Board was developed to insulate cold storage spaces and in view of the severe shortage of cork, was of great importance in the construction of vessels used for transporting food to the South Pacific areas.

[1] Lt. Comdr. A. H. Holden, USNR, Buoyant Materials for Navy Life Preservers in World War II; United States Naval Institute Proceedings, vol. 72, No. 524 (October 1946), pp. 1327–1330.

Bomber plants

Fiberglas PF insulating wool in board form was developed also into a roof deck insulation during the war years. It was a necessary feature in the construction of the all-steel assembly plant—essential to the assembly line production of large aircraft, and large quantities were used in constructing war plants. Thus, on the Bell bomber plant at Marietta, Ga., there were used 3,640,000 square feet. And in the Consolidated and Douglas bomber assembly plants at Forth Worth, Tex., and Tulsa, Okla., there was used a total of 19,400,000 board feet of Fiberglas insulation. The assembly building of each plant was 4,000 feet long, 320 feet wide and 60 feet high, but despite the enormous spans, the roof would carry a live load of 25 pounds per square foot and yet weighed less than 11 pounds per square foot above the trusses.

In addition to its use on the roof deck, 6-pound PF wool was used also to insulate the side walls of bomber plants, being applied prior to the corrugated metal sheeting.

The ceilings of the bomber plants were insulated with 1½-pound white wool, 3 inches thick and held in place by metal lath. Bonded mat was placed between the wool and the lath to keep any loose fibers from falling down.

The side walls also were insulated on the inside surface with white wool of 1½-pound density and 4-inch thickness compressed to three. This was covered with bonded mat and metal lath in the same manner as was done on the ceiling. Thus both thermal and acoustical insulation was provided for ceiling and side walls: 9,529,000 square feet of TW-F wool in rolls and batts were supplied for bomber-plant insulation.

Thermal insulation

The Army Ground and Air Forces used Fiberglas wool as a thermal insulation in cantonment buildings, portable shelters, refrigerators, portable food and water containers, troop kitchen cars and ammunition trucks.

Portable shelters for use by Army Air Force personnel in Arctic climates—shelters sufficiently light and compact to be transported by air—contained Fiberglas insulation in walls and sometimes in flooring, to cut the amount of fuel required to maintain livable temperatures. The Fiberglas insulation in a typical shelter weighed only about 200 pounds, yet it saved over 20,000 pounds in the weight of fuel required to be transported for such a shelter during a season: 3,452,425 square feet of Fiberglas insulating batts were supplied for such Army Air Corps Arctic shelters.

In addition to the newer products developed during the war, aircraft blankets surfaced with Fiberglas cloth and filled with Fiberglas wool were used to insulate military aircraft against cold and noise: 205,700 square feet of this material was supplied during the war.

Pipe covering

In many war plants Fiberglas pipe covering was used to insulate miles of piping through which flowed gas, steam, water, oil, and other fluids. In one ordnance plant in the Middle West more than 1,000,000 linear feet of Fiberglas pipe covering was used to insulate such pipelines. Among the plants supplied were Hercules Powder Co. at Hopewell, Va.; target-loading plant at Yorktown, Va.; torpedo-loading plant of the Navy Mine Depot at Yorktown, Va.; Plum Brook ordnance plant at Sandusky, Ohio; and Erie proving ground at Camp Perry, Ohio.

Sound stacks

Fiberglas wool in the form of blankets between perforated metal sheets is used in sound stacks at airfields throughout the United States. The testing of airplane engines requires that the sound-absorbing material be able to withstand the effects of lubricating oils, gasoline, water vapor, and the terrific wind velocities generated by the propellers.

YARNS AND FABRICS

Fiberglas yarns and fabrics had been developed commercially before the war, but during the emergency they were of great significance in providing materials of high military importance. Fiberglas cloths are strong, relatively thin, temperature-resistant fabrics woven of Fiberglas yarns. They do not shrink or swell with moisture changes; they cannot burn and are unaffected by most acids, corrosive vapors, and oils.

Reinforced plastics

Fiberglas cloth was used as a reinforcement for low-pressure plastic laminates to provide high-strength-weight ratio, high impact resistance and dimensional stability.

Panel board

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Panel board

During the war 5,804,204 yards of cloth were furnished to supply those characteristics to Navy panel board.

Doron

Another important use for the laminates occurred in the production of Doron, a new type of body armor made of Fiberglas ECC-165 cloth bonded with a plastic resin. The glass resin sheets were light, easily jettisoned, and, unlike steel, did not rust or corrode. They were easily fitted to a modified Navy life jacket and were adopted by the Navy to protect invasion forces from shrapnel while landing from barges.

Wing liner

Used with styrene-polyester thermosetting resins, Fiberglas cloths answered the wartime requirement for liners in the wings of aircraft to protect fuel cells from flowering metal caused by bullet punctures.

Radomes

The same combination of Fiberglas cloth and resin furnished housing for radar under the name Radomes.

Other uses

Medical kits for the Army Medical Corps and Army Air Corps also were made from glass-reinforced plastics and at the termination of the war it was contemplated that helmets, flak suits, and protective armor for planes would be made from the same material.

Coated cloths

Fiberglas cloths and yarns also had many wartime uses when made into fabrics coated with natural and synthetic rubbers, vinyl resins, and other coating compounds.

Flare shades

An essential part of each of the magnesium-charged flares which were used in the invasion of Europe was a shade or umbrella of Fiberglas-coated cloth. These shades served to protect the flare's chute from the intense heat and to shield the eyes of the bombardier from the glare of the light.

To produce the needed flare shades speedily, Fiberglas teamed with a score of other manufacturers whose locations ranged from Connecticut to California. Small fabricators also joined in to do special sewing and packaging. For this essential activity Fiberglas supplied 8,020,194 yards of cloth and 156 tons or 312,000 pounds of tying cord.

It is also worthy of mention that when the military need for flare shades had ended and a drastic cancellation of the program became necessary, Fiberglas worked out a plan whereby no termination claims were presented to the Government, a fact which was recognized officially by the War Department through an expression of appreciation.

Water tanks

Coated Fiberglas fabrics were used also to construct portable water tanks for use in tropical areas. The resistance of Fiberglas cloth to fungi and molds led to its use in place of cotton duck. Each tank was 12 feet in diameter, 5 feet high and had a capacity of 3,000 gallons. The initial order was for 300,000 yards of Fiberglas 164 cloth; Buna S was used to coat the first tanks and vinyl coatings were used later.

Other uses

Because of their resistance to heat, moisture, oils, and most acids, and because of their toughness and dimensional stability, coated Fiberglas cloths found wide application in the fabrication of ducts for the effective, safe distribution of air in aircraft.

Coated Fiberglas cloths also were used as aircraft battery covers and for covering machinery and equipment in military winterizing programs; in addition, these cloths were used as coverings for cots and berths in military air-transports, as fire wall gaskets, and during the war years the material was first used for industrial conveyor belts.

The dimensional stability of Fiberglas cloth was utilized in developing a gun-sight checking screen which saved many valubale moments in preparing fighting aircraft for combat. For the same reason Fiberglas cloths were used in making geodetic survey maps.

Cloths without coating

Fiberglas fabrics, without the coatings described above, also had many wartime uses.

In electrically heated diving suits worn by Navy divers to enable them to withstand the paralyzing cold encountered at great depths, the wires carrying the current were enclosed between layers of Fiberglas cloth. Fiberglas cloth—incombustible and heat resistant—was used so that should a wire break, a spark would not ignite any combustible material which would burn fiercely in the helium-oxygen gas, widely used in diving operations in place of compressed air.

Wire netting "garnished" with Fiberglas fibers and painted to blend with the terrain was used to comouflage possible bombing objectives in seacoast areas where there was required a material resistant to salt and dampness.

Lagging cloth, used in wrapping insulated pipes, was another product which Fiberglas Corp. furnished to the war effort in large quantities. It was particularly desirable because it was strong, firesafe, absorbed a minimum of paint, and resisted moisture and corrosion: 4,734,931 yards were supplied to shipbuilders and 534,436 yards to aircraft manufacturers. Great quantities also went into war production plants. To sew pipe lagging there were supplied 25 tons of lagging thread.

Tapes

Fiberglas yarns also were woven into stripping and lagging tapes used in finishing an application of insulation: 224,780,584 feet of this material were furnished to shipbuilders from Pearl Harbor to VJ-day.

Electrical insulation

Even prior to the war, Fiberglas cloths, tapes, and yarns had been developed into a highly efficient electrical insulation. The value of this insulation in the war program lay primarily in its resistance to the forces that always are at work seeking to break down the insulation. Chief of these are high temperatures and moisture. Further, the comparatively small space taken up by Fiberglas electrical insulations made it possible for skilled engineers to decrease the size and weight of motors and generators used in planes, on shipboard, and in tanks. Such small, lightweight motors operated under high temperatures, high overloads, and hard usage over long periods of time.

Overloads

An outstanding illustration of the worth of Fiberglas electrical insulation is found in the experience of Wilhite Woodworking Co. of Chicago. This concern, in war production for Ordnance, was able to use on its drill-press motors a 3-horsepower winding on a 1½-horsepower frame, and even then to overload in excess of 5 horsepower. As a result of the increased output of the presses and the elimination of motor failures, production was increased to such an extent that only one shift was used where two had been employed previously. To obtain the same results through the use of larger motors would have meant replacing the drill presses with larger and more expensive machinery.

Propeller pitch-change motor

One of the tiniest but at the same time most vital motors in a plane is the propeller pitch-change motor. Hidden in the propeller assembly, the motor has to be small enough to fit in the restricted space, yet powerful enough to change the pitch of a propeller that has gone dead, so the blades can be turned edgewise to the wind. These tiny motors were insulated with Fiberglas electrical insulation.

Ignition cable

Whenever and wherever humidity is high, electrical insulation is subject to the danger of moisture penetration. Moisture could so affect the electrical system of a fighter or bomber plane as to prevent a quick take-off. Using Fiberglas yarn, an ignition cable was developed which helped assure a quick take-off even though the plane had been subjected to conditions of severe and prolonged humidity.

Radio hook-up wire

Because Fiberglas yarn resists intense heat and will not support fungus growth, large amounts of radio hook-up wire for aircraft transmitters and receivers were insulated with the material.

Deck motors

Navy deck motors were equipped with Fiberglas insulation primarily because of its resistance to moisture and its ability to stand up under prolonged overloads.

Propulsion equipment

Propulsion equipment on Navy ships was largely Fiberglas insulated because of the reliability and stamina that could be built into such units by using glass insulation and suitable varnishes, thereby permitting severe overloads.

Cables

Several types of heat- and flame-resistant Navy cables were developed by using Fiberglas insulation. Armored cables were lightened and the amount of metal reduced by using wrappings of Fiberglas barrier tapes.

Fiberglas staple fibers also were used as cable filling.

Blood-plasma filter

Another wartime product of Fiberglas textiles, involving no great volume of production but of vital importance, was the tiny strip of tape, woven of glass fibers, employed as a filter in the tubing of the light, portable apparatus used to give blood-plasma transfusions—frequently just behind the front lines. The Fiberglas tape was used as the filter because the tape could be sterlized for repeated use, because it required no bulky housing, because the weave was close enough to strain out any undissolved particles the fluid might contain and, because, being glass, the fibers did not swell when wet, thus offering no impediment to the free passage of the fluid.

BONDED MAT

Fiberglas products in mat form also constituted a substantial contribution to the war effort.

Bomber plants

In bomber assembly plants, 4,520,000 square feet of bonded mat were used for light diffusion in "ferrosteel" construction. Bonded mat was used also to retain white wool in ceiling and side-wall applications.

Battery mat

Fiberglas battery retainer mats, whether used in land, sea, or aircraft, added to battery performance under gruelling conditions. In submarines the mats added to the cruising radius by lengthening the life of the battery; in tanks they enabled the batteries to withstand terrific jouncing without failure. In addition, battery mat was of real importance in civilian life due to the greatly increased reliance on replacement batteries and the need for increasing the life of all batteries during the war years.

Separators

Fiberglas battery separators, made from bonded mat, were developed during the wartime shortage of rubber from which such separators are normally made.

Other uses

Fiberglas in mat form was used also as a base in plastic laminations to produce high-frequency, low-electrical-loss parts for radio, radar, and other electronic equipment. Fiberglas mat (25 mil furfural bonded) was used to prevent the silica gel, contained in air driers, from sifting through the perforations in the cartridges. The mat had sufficient porosity to allow the passage of air while retaining its original shape. Such air driers were employed to keep war materials of all kinds free from rust, corrosion, mildew, or mold while in storage or during shipment.

AIR FILTERS

Fiberglas dust-stop air filters were developed originally in connection with forced warm air heating systems, but during the war air conditioning and cleaning systems, of which such filters are an integral part, became essential to efficient production of military supplies.

Eighty thousand dust-stop air filters comprised the original installation for the atomic bomb project at Oak Ridge, Tenn., and sixteen thousand replacements were needed every 6 weeks.

Other large installations were made in the paint spray buildings of bomber assembly plants.

In war plants of all kinds, Fiberglas air filters removed from the air tiny particles of dust that could ruin the accuracy of gun and bomb sights, shorten the life of engines and motors, or cause explosions. Telephone exchanges also had to be kept free of dust in order to operate efficiently.

In ordnance plants, the filters were employed to collect from the air particles of TNT and other explosive dusts created by manufacturing operations.

In plants manufacturing precision instruments and machine parts, Fiberglas filters were used to collect dusts created by grinding processes, thus eliminating a hazard to the products being manufactured and to the health of workers in the plant.

In addition, planes, tanks, trucks and other military equipment were equipped with Fiberglas air filters to prevent the admission of abrasive dusts to the carburetor or lubrication system.

The foregoing material illustrates to some extent the direct relationship of Fiberglas products to the military program of the Government. No less important to the war effort were the many significant industrial applications that helped increase output, diminish the breakdown or maintenance of electrical equipment, or conserved fuel and power. Mines, oil refineries, steel mills, railroad, bus transportation systems, and a host of other critical industries and services benefited through the contributions of these products.[3]

Exhibit 2

Owens-Corning Fiberglas Corp.—Statistics of facilities, assets, sales, and net income, 1945–50

	Number of plants	Unadjusted basis of facilities	Adjusted basis of facilities	Total assets	Net sales	Net income [1]
1940	1	$3,900,000	$2,700,000	$6,600,000	$9,600,000	$647,000
1945	2	8,400,000	3,200,000	30,400,000	46,000,000	5,300,000
1946	3	15,000,000	9,000,000	26,000,000	33,000,000	1,000,000
1947	4	21,400,000	14,000,000	31,000,000	41,000,000	1,000,000
1948	4	24,000,000	16,000,000	40,000,000	51,500,000	5,500,000
1949	5	32,000,000	22,000,000	45,000,000	49,000,000	3,700,000
1950 (first 6 months)	5			49,000,000	[2] 68,000,000	[2] 12,000,000
1950	5	34,000,000	23,500,000	59,000,000	78,000,000	16,000,000

[1] Before Federal income and excess profits taxes.
[2] First 6 months annualized.

Exhibit 3

NEED FOR ADDITIONAL RELIEF PROVISION IN THE EXCESS PROFITS TAX ACT TO AVOID EXCESSIVE TAXATION OF NORMAL EARNINGS OF CORPORATIONS DEMONSTRATING EXTRAORDINARY GROWTH—OWENS-CORNING FIBERGLAS CORPORATION—AN EXAMPLE

SUMMARY

1. During the base period 1946–49, we

Quadrupled our investment in plant. (The unadjusted basis of our plant facilities increased from $8,400,000 on January 1, 1946, to $32,000,000 on December 31, 1949.)

[3] H. D. Keiser, Maj. U. S. Army; American Institute of Mining and Metallurgical Engineers, Technical Publication No. 1598; New York Meeting, February, 1943.

Doubled our productive capacity. (Our peak World War II sales were $46,000,000 in 1944, excluding outside fabrication, utilizing our full capacity. On December 31, 1949, our facilities had an annual production potential of $100,000,000.)

Doubled our sales. (Nineteen hundred and forty-six sales were $33,000,000 compared with an annual rate of $68,000,000 for the first 6 months of 1950.)

Increased our earnings more than tenfold. (Our net income before taxes in 1946 and 1947 was $1,000,000 compared with an annual rate of $12,000,000 for the first 6 months of 1950.)

2. Our average base period net income was only $3,400,000. (The average of our three best base period years.)

3. By December 31, 1949, we reached an earnings level of more than $12,000,000. (Our actual earnings before taxes for the first 6 months of 1950, prior to the Korean outbreak, were $6,000,000.)

4. Our excess profits tax credit, however, will be only $6,000,000. (Under the amendment proposed by the Ways and Means Committee, the credit for base period earnings would be only $5,300,000 for 1951 and subsequent years.)

5. Without additional relief we will not only pay excess profits taxes on all earnings attributable to the defense program, but on 50 percent of our normal peacetime earnings, as well.

I. THE PROBLEM

The 1950 excess profits tax was intended to apply to corporate profits which were swollen by the increased tempo of the defense economy. Congress recognized, as it had in the World War II act, that its taxing provisions, no matter how carefully chosen, would result in excessive and discriminatory taxation on normal earnings as applied to many corporations. Instead of providing a general relief provision for these cases, similar to section 722 of the earlier statute, it prescribed rigid formulas for determining the amount of relief and inflexible standards in defining eligibility for relief.

When queried on the floor of the Senate concerning the absence of a section 722, Senator George said:

"The present bill approaches the same problem but undertakes to spell out relief for new corporations formed after the base period began, for depressed industries, for companies having abnormalities, and for other corporations which we thought were entitled to relief. *Whether the committee has gone far enough and whether those relief provisions will be altogether effective, of course, remains to be demonstrated or disproved in the administration of the act.*" [Italics ours.]

Owens-Corning Fiberglas Corp. is a striking example of the inadequacy of the relief provisions of the present law. They fail to eliminate excessive and discriminatory taxation on our normal earnings. We are deprived of profits which have resulted from growth in sales and productive capacity accomplished prior to, and which had no relation to, the Korean outbreak.

Our earning capacity in the postwar years was greatly diminished because of the dedication of our efforts to war production in World War II, and the consequent loss of position and opportunities in our civilian markets. Increased productive capacity of nonwartime character and revitalization of sales, production and research efforts for civilian markets were necessary before a reasonable level of earnings could be achieved. It was not until the first 6 months in 1950, prior to the Korean war, that the results appeared. Compared with the beginning of the base period, our sales level and productive capacity were doubled, and our earnings increased more than tenfold. Our investment in plant almost quadrupled, increasing during this postwar period from $8,400,000 to $32,000,000. As a result, during the 6 months preceding the Korean outbreak we reached an earnings rate in excess of $12,000,000 a year. Our excess-profits tax credit, under the most favorable relief provision, however, will be only $6,000,000.

Congress has therefore subjected to excess-profits taxes not only all of our earnings attributable to the defense program, but 50 percent of our normal peacetime earnings, as well.

We believe that the Congress did not intend to place a growing and expanding corporation under such a serious competitive disadvantage and subject its normal peacetime earnings to an excessive and discriminatory tax. Indeed, officials of the company realize that Congress sought earnestly to provide adequate relief for corporations experiencing this type of extraordinary growth.

Senator George on the floor in the closing debate on the bill with particular reference to the absence of a general relief provision such as section 722 confirms our belief:

"*Whether these formulas [the new relief formulas] will adequately meet these situations, of course the committee cannot say. We only express the hope that they will,* and we have taken the extraordinary step of providing for the rewriting of this bill by the end of December 1952 in order that we may meet the problems which, through experience, are then presented to us in a clearer light in the *very brief hearing* the committee was able to hold on this bill." [Italics ours.]

This memorandum has been prepared to demonstrate that the rigid formulas provided in the Excess Profits Tax Act of 1950 did not adequately meet these situations involving dynamic growth companies. It is submitted that additional relief provisions are necessary if Congress is to avoid an unintended inequity in this, and, no doubt, a good number of other cases in which either the rules of eligibility or the extent of the relief provided result in taxing as excess profits an undue and excessive percentage of normal earnings.

Such provisions need not await a rewriting of the bill at the end of December 1952. They should be provided now to meet the basic intent of Congress.

II. UNFAIRNESS OF THE 1950 EXCESS-PROFITS TAX LAW AS APPLIED TO OWENS-CORNING FIBERGLAS CORP.

The Excess Profits Tax Act of 1950 penalizes Fiberglas by subjecting normal profits to excess profits taxation. The relief provisions do not relieve this penalty. The new level of profits which we reached during the first 6 months of 1950 resulted from the expenditure of $23,000,000 [1] in plant expansion during the base period, and the plowing back of base period earnings into research, market development and personnel training. Our new profits were not war profits, but the result of carefully planned expansion.

Under the present law we cannot continue this policy of expansion; cannot even compete on equal terms with mature and well-established companies in our field whose growth in their peacetime markets was not interrupted by World War II, and who therefore did not have throughout the base period the many serious problems of expansion and market imbalance which we faced.[2]

The history of our growth clearly demonstrates the unfair effect of the present law upon us. Owens-Corning Fiberglas Corp. was organized in 1938. We were pioneers in the development of glass fibers, competing in the building and domestic appliance insulation and textile fields. Our principal products were home insulation, domestic appliance insulation, and air filters. We were just becoming established when the World War II preparedness program began. To make the maximum contribution to the war effort we abandoned our civilian products and converted almost entirely to war materials. As a result, we lost most of our newly created markets and newly found customers. Our extensive research projects designed to develop civilian uses for Fiberglas products were shelved for the duration and our research efforts were shifted to the development of materials for war. Throughout the entire war period more than 90 percent of our production was for war purposes, a great proportion of which had no carry-over into civilian markets.

When V-day came and our war contracts were canceled, our production facilities were completely out of balance with our civilian markets. We had expanded our production of textile fibers more than 700 percent to meet requirements of the Armed Forces for specialized products which had no counterpart in civilian markets. Throughout the war textiles represented 66 percent of our production. In the postwar economy, textiles fell abruptly to 20 percent of our production. We had been forced to withdraw almost entirely from our established home and appliance insulation markets because our one insulating-wool plant had been preempted for high-priority war uses. Thus 1946 found our company with a potential demand for insulation greatly in excess of the capacity of our one wool plant, but with two war-created plants equipped to produce textile fibers for which civilian demand was undeveloped except to a limited extent in the electrical-

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[1] This new investment compares with total unadjusted basis of plant facilities at December 31, 1945, of $8,400,000, an increase of 275 percent.

[2] For example, one of our principal competitors in the insulation field, a large well-established company expanding at a far lesser rate than we were during the base period, paid excess profits taxes on only $7,800,000 of its 1950 income of $38,500,000. In other words, its credit amounted to 80 percent of its 1950 income, and only 20 percent was subjected to excess profits tax.

One of our principal textile competitors, which expanded very little during the base period, paid excess profits taxes on only $6,300,000 of its 1950 income of $22,300,000. Its credit thus amounted to 72 percent of its 1950 income, and only 28 percent was subject to excess profits tax.

Contrast these examples with our case. Our credit on the most favorable basis will be only $6,000,000 compared with 1950 income of $16,000,000. Our credit will thus be only 37½ percent of our 1950 income, leaving 62½ percent to excess profits tax. Unless additional relief is granted, we face the certain prospect of paying the maximum over-all tax for the duration of the emergency.

insulation field. In addition large Government surpluses of Fiberglas textiles more than saturated our meager textile market.

To meet the crisis which faced us, we turned all of our energies and resources to the construction of facilities to meet the rapidly expanding needs for house and appliance insulation and to build up our market position in these fields. During the years 1946 to 1949 we constructed two new plants and reconverted and rehabilitated three existing plants at a cost of more than $23,000,000.

We also instituted vigorous research and sales programs to develop markets which would absorb the capacity of our textile-fiber facilities. For the 4 years immediately following the war our textile capacity was four times our average textile sales. It was not until the last quarter of 1949 that the fruits of this broad expansion and development program began to be realized to any substantial degree.

During the entire period 1946 to 1949 our profits were seriously depressed by these efforts to expand our insulation production and our textile markets. Our costs were increased far above normal by—

(1) Losses sustained in developing and introducing new products;

(2) Abnormal costs of recruiting and training manufacturing personnel prior to the commencement of production of new facilities;

(3) High initial costs of operating new facilities; and

(4) The myriad of other shake-down problems necessarily involved in a program of such magnitude for the expansion of wool capacity, on the one hand, and in seeking outlets for surplus textile capacity, on the other.

By the end of 1949 the gradual development of many new textile markets indicated that for the first time since World War II our textile capacity could be operated at a profitable rate early in 1950. The expansion program to provide additional insulation capacity was nearly finished. Facilities having a production potential of more than $100,000,000 had been completed, and it was anticipated that a level of sales fully utilizing this capacity would be reached within 2 years. The first 6 months of 1950 bore out our expectations with record sales of $34,000,000 and earnings of $6,000,000. This potential annual level of income of $12,000,000 at the end of 1949 was in no way related to the war. These were normal 1950 earnings for a corporation which had attained a new level of growth. In fact, additional expansion of sales and profits beyond the $12,000,000 level was clearly indicated as the result of the growth of our facilities and markets by December 31, 1949.

The following tabulation shows the extent of our expansion program and its effect upon our sales and earnings:

	Number of plants	Unadjusted basis of facilities	Adjusted basis of facilities	Total assets	Net sales	Net income [1]
1940	1	$3,900,000	$2,700,000	$6,600,000	$6,600,000	$647,000
1945	2	8,400,000	3,200,000	30,400,000	46,000,000	5,300,000
1946	3	15,000,000	9,000,000	26,000,000	33,000,000	1,000,000
1947	4	21,400,000	14,000,000	34,000,000	41,000,000	1,000,000
1948	4	24,000,000	16,000,000	40,000,000	51,500,000	5,500,000
1949	5	32,000,000	22,000,000	45,000,000	49,000,000	3,700,000
1950 (first 6 months)	5			49,000,000	[2] 68,000,000	[2] 12,000,000
1950	5	34,000,000	23,500,000	59,000,000	78,000,000	16,000,000

[1] Before Federal income and excess-profits taxes.
[2] First 6 months annualized.

The normal earnings level of our corporation at the end of 1949 was thus in excess of $12,000,000. But let us see what credit is allowed us under the 1950 Excess Profits Tax Act. There are six applicable credit provisions.

(a) Inadequacy of the earnings credit (sec. 435 (d))

Our credit under this section would be only $4,000,000 as compared with our normal earnings of $12,000,000. This credit is based primarily upon the average net income of the three best years, 1946 to 1949. It obviously, therefore, does not reflect the new high level of earnings reached at the end of 1949 as the result of our broad expansion program.[3]

[3] For 1951 and subsequent years the credit attributable to base period earnings would be reduced from $4,000,000 to $3,500,000 under the amendment proposed by the Ways and Means Committee in the forthcoming Revenue Act of 1951. This amendment allows only 75 percent instead of 85 percent of the average net income of the three best base-period years.

(b) Inadequacy of the invested capital credit (sec. 436)

Our credit based on invested capital is even a poorer measure of normal earnings. It would be only $3,000,000 compared to normal earnings of $12,000,000. This credit works out to a return of only 7½ percent before taxes upon our equity and borrowed capital.[4] It goes without saying that such a return is entirely unrealistic for a dynamic young corporation creating broad new markets and demands.

(c) Inadequacy of t' growth formula (sec. 534 (e) (1) (B))

To qualify under this section we must fit the following three requirements designed primarily to afford relief to the television industry;

(i) Twice net sales for period January 1, 1950, to June 30, 1950, must be 150 percent or more of a'erage net sales for 1946 and 1947; and

(ii) Forty percent of t sales for 1950 must be attributable to products not generally available to public before January 1, 1946; and

(iii) Net sales of new products for 1949 must be 20 times such amount for 1946.

We qualify easily under test (i). But even though we have introduced many new products since January 1, 1946, and have greatly changed and improved others, there is some question whether we will meet (ii) and (iii). Much will depend upon the Treasury's interpretation of what constitutes a product not generally available to the public before January 1, 1946.

But even assuming we qualify under this section, what will be the measure of our relief? At best there will be a credit of only $7,000,000[5] only 58 percent of our normal earnings. In other words, $5,000,000 of our normal earnings will be subjected to excess-profits tax each year.

The defect in this section is that it assumes that both 1949 and 1950 were normal years. It does not provide relief for a corporation such as ours which did not attain its growth until the very end of the base period. We were still suffering growing pains in 1949. Construction of our fifth plant was completed during that year, and our new textile markets were just beginning to materialize. A credit based primarily on 1949 earnings, therefore, cannot possibly afford us a fair measure of relief.[6]

(d) Inadequacy of the relief provisions

Three of the relief provisions were intended to provide relief in situations such as ours; i. e., section 442, dealing with abnormalities during the base period; section 443, relating to changes in products; and section 444, relating to increases in capacity for production or operation. We meet the tests necessary to qualify under one or more of these sections. The tests will be discussed below. The relief afforded, however, is entirely inadequate because all of these sections have the same major defect as applied to our situation: the reconstructed credit is based upon the average rate of return realized by all corporations making up our industry.

Since our gross receipts for 1949 were entirely from the sale of products made of glass, it is assumed that our industry will be deemed to be the stone, clay, and glass industry[7] for which the base period rate of return has been tentatively

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[4] A return of 7½ percent before taxes means only 4.35 percent after normal and surtax of 42 percent.

[5] See the following:

Forty percent of 1950 earnings	$6,400,000
Fifty percent of 1949 earnings	1,800,000
Total	8,200,000
Less 15 percent	1,230,000
Net	6,970,000

For 1951 and subsequent years the credit attributable to base-period earnings would be only $6,100,000 under the Ways and Means Committee amendment.

[6] We cannot qualify under another set of tests based upon payroll and gross receipts and applicable to corporations having assets of less than $20,000,000 on January 1, 1946 (sec. 435 (e) (1) (A)). The credit would be inadequate, even if we qualified, for the same reasons as in the case of sec. 435 (e) (1) (B).

[7] Our 1949 gross sales by product groups were approximately as follows:

Building materials	$14,000,000
Equipment and appliances	15,000,000
Transportation	5,000,000
Air conditioning	3,000,000
Battery and corrosion products	2,000,000
Industrial insulation	3,000,000
Textiles	6,000,000
Textile reinforcements	1,000,000
Total	49,000,000

announced as 16.5 percent before taxes.[8] The rate of return of this industry has little relation to our earning capacity. It is an industry made up of a heterogeneous group of businesses using widely different raw materials and manufacturing processes and supplying a wide variety of markets. The industry rate of return, therefore, is a conglomerate of returns on such widely different products as tombstones and sewer pipes, concrete and papier-mâché statuary. It could not possibly represent a fair return for us. Our normal rate of return before taxes is in excess of 25 percent. This rate of return was attained during the 6 months' period ending June 30, 1950. Our actual rate of return before taxes for the year 1950 was 27 percent. No relief provision using an industry rate of return such as that now provided can possibly provide us with a fair measure of normal earnings.[9]

1. *Abnormalities during base period (sec. 442).*—We may qualify under this section on the ground that our normal production was diminished because of the occurrence immediately prior to and during the base period of events unusual and peculiar in our experience; i. e., the necessity of converting from almost total war production to civilian production. Or we may qualify on the ground that our business was depressed because of temporary economic circumstances unusual in our experience. Here again much will depend upon the severity or liberality of the Treasury's interpretation of the statute.

The credit allowed, however, would be measured by our industry rate of return upon the average of our total assets as of the end of each year of the base period. Our credit would be only $5,000,000, or less than half our normal earnings.

2. *Change in products (sec. 443).*—To qualify under this section, 40 percent of a taxpayer's gross income or 33 percent of its net income during an excess-profits year must have been from new products introduced during one of the preceding 3 years which is a base period year. In addition, its net income for the taxable year must exceed 125 percent of its net income for the base-period years prior to the introduction of the new products.

We will clearly qualify under the latter requirements, since our net income will have increased more than tenfold since the beginning of the base period. Whether we will be deemed to have introduced sufficient new products will depend upon the Treasury's interpretation of the statute.

In any case, however, the credit allowed would be measured by our industry rate of return upon our total assets on December 31, 1949. This would amount to only $6,000,000,[10] half our normal earnings.

3. *Increase in capacity (sec. 444).*—A taxpayer qualifies under this section if during the years 1947 to 1949—

(i) As the result of additions and replacements, its capacity for production or operation on December 31, 1949, was 200 percent or more of such capacity on December 31, 1946, or

(ii) Such capacity on December 31, 1949, was 150 percent or more of such capacity on December 31, 1946, and the adjusted basis of its total facilities on December 31, 1949, was 150 percent or more of such basis on December 31, 1946; or

(iii) The unadjusted basis of such facilities on December 31, 1949, was 200 percent or more of such basis on December 31, 1946.

We undoubtedly qualify under one or more of these three alternative tests. But our credit will be measured by the base-period rate of return of our industry. Our credit would be only $6,000,000,[11] half our normal earnings.

III. PROPOSED ADDITIONAL RELIEF PROVISIONS

Our case is unusual but certainly not unique. There will be other corporations which have enjoyed extraordinary growth and reached a new level of sales and income at December 31, 1949. Such corporations are not protected by the relief provisions of the 1950 act. They should be entitled to a credit reflecting the new level of growth attained at the end of the base period.

Such a credit could be provided by several methods along the following pattern. It could be provided by a specific growth formula similar to that now applicable

[8] A return of 16.5 percent before taxes means only 7.92 percent after normal and surtax of 52 percent, the rate proposed for 1951 under the Ways and Means Committee amendment.

[9] The stone, clay, and glass products major group is made up of 9 subgroups, consisting of 29 separate industries. They include flat glass, pressed and blown glass, brick and tile products, sewer pipe, vitreous plumbing fixtures, pottery, concrete products, gypsum products, lime, mineral-wool products, cut stone products including tombstones, abrasives, and oven statuary and art goods made of plaster of Paris and papier-mâché.

[10] Only $5,300,000 for base-period earnings for 1951 and subsequent years under the Ways and Means Committee amendment.

[11] See footnote 10.

to the new-product corporation. No valid reason is apparent for providing a growth formula in the one situation and not in the other. Such a credit could also be provided by a general relief provision similar to old section 722.

A recommended formula which would grant the corporation experiencing extraordinary growth the same type of relief as is now afforded the new product corporation is as follows:

(a) *Specific relief formula for extraordinary growth*

Tests.—Taxpayer experienced extraordinary growth during the base period as evidenced by the fact that—

(1) Twice taxpayer's net sales for the period January 1, 1950, to June 30, 1950, is 50 percent or more in excess of the average for 1946 and 1947; and

(2) During 1946 to 1949 taxpayer (i) doubled its productive capacity, or (ii) increased its productive capacity by 50 percent or more and the adjusted basis of its facilities by 50 percent or more or (iii) doubled the unadjusted basis of its facilities; and

(3) Either (i) twice taxpayer's excess profits net income for January 1, 1950, to June 30, 1950, or (ii) its "weighted excess-profits net income" for its first excess-profits tax taxable year is 200 percent or more in excess of its average base-period net income.[12]

Credit.—Eighty-five percent of either (1) twice taxpayer's excess profits net income for January 1, 1950, to June 30, 1950, or (2) its "weighted excess-profits net income" [12] for its first excess-profits tax taxable year, at the taxpayer's election.

This formula is based on tests similar to those already adopted and could be made effective by simple amendments to section 435. Test (i) is the same as the sales test of the present growth formula for the new product corporation, section 435 (e) (1) (B) (i). Test (ii) is similar to the capacity tests of section 444. Test (iii) is similar to the income test of the change in products relief provision, section 443 (a) (3), but the percentage increase in income is made more stringent by increasing it from 25 to 200 percent.

Under this formula our credit would be $10,880,000,[13] a credit more nearly commensurate with our normal peacetime earnings level of $12,000,000.

A suggested draft of the basic amendments to section 435 to make this additional growth formula effective is set forth in the appendix.

(b) *General relief provision.*—An alternative to such a growth formula, if Congress should decide not to enact further specific relief provisions, would be the reenactment of a general relief provision similar to section 722 of the World War II excess-profits tax.

To eliminate the administrative difficulties which have greatly delayed the disposition of cases under that section, however, it is recommended that Congress review the rulings and policies of the Excess Profits Tax Council and enact detailed clarifications of its intent.

One of the primary lapses in section 722 has been the delay, both on the part of the taxpayer and the Government, in reaching a final administrative determination. Any re-enactment should require the filing of claims under the new provision within 1 year of the due date of the return for the year involved, thus requiring the taxpayer to act promptly.[14] It should also require a final administrative determination upon the claim within 1 year of its filing. Thus, if the taxpayer is not satisfied with the credit allowed, it can go promptly to the tax court. It must be recognized that an excess-profits tax is an emergency measure and, therefore, does not permit of processing in the normal course.

Most important, however, in order to reduce administrative judgment to a minimum, there should be written into the law statutory standards for qualification for relief and for measuring the scope of the relief to be allowed. In the case of growing corporations, for example, such statutory standards should include substantial growth in sales, plant facilities, and net income. They should be similar to the tests of the proposed formula for extraordinary growth. Any taxpayer meeting all of these high standards would qualify for relief, at least presumptively. Administrators of the law would also be guided by these standards in granting relief to other taxpayers not able to meet them all.

[12] "Weighted excess-profits net income" is 80 percent of the excess-profits net income for the calendar year 1950, and varying greater and lesser percentages in the case of fiscal years (sec. 435 (e) (2) (E)).

[13] See the following:

80 percent of 1950 earnings	$12,800,000
Less 15 percent	1,920,000
Total	10,880,000

[14] Or 1 year from the adoption of the provision, whichever is later.

The amendment should also provide that taxpayers who qualify and meet all the standards prescribed in the formula would be allowed the level of earnings actually attained during the first 6 months of 1950 as a reasonable minimum reconstruction of normal earnings. Excess profit taxes would then be imposed only on the earnings in excess of this amount. Taxpayers would be permitted to show that a greater level of earnings would have been reached had the changes in their business been made 2 years earlier, as under section 722.

Similar formulas should be prescribed to establish standards of qualification and scope of relief for the other changes in business encompassed by the section. Such standards for qualification and for reconstruction should eliminate to a very great extent the administrative difficulties encountered under section 722.

APPENDIX

PROPOSED AMENDMENT PROVIDING ADDITIONAL FORMULA FOR EXTRAORDINARY GROWTH

Section 435 (e) (1) should be amended by adding the following new subparagraph:

"or,

"(C) (i) the taxpayer's net sales for the period beginning January 1, 1950, and ending June 30, 1950, when multiplied by 2, equals or exceeds 150 percent of its average net sales for the calendar years 1946–47, as provided in subparagraph (B) (i); and

"(ii) the taxpayer during its base period made an addition or additions to its facilities or replaced all or a part of its existing facilities, and as a result of such additions or replacements:

"(I) its capacity for production or operation on the last day of its base period was 200 percent or more of its capacity for production or operation on the day prior to the beginning of its base period, or

"(II) its capacity for production or operation on the last day of its base period was 150 percent or more of its capacity for production or operation on the day prior to the beginning of its base period, and (B) the adjusted basis for determining gain upon sale or exchange of its total facilities on the last day of its base period was 150 percent or more of the adjusted basis for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of its base period, or

"(III) the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the last day of its base period was 200 percent or more of the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of its base period; and

"(iii) the taxpayer's (I) excess profits net income for the period beginning January 1, 1950, and ending June 30, 1950, multiplied by 2, or (II) the taxpayer's 'weighted excess profits net income' for its first excess-profits tax taxable year under this subchapter, determined as provided in paragraph (2) (E), equals or exceeds 300 percent of the taxpayer's average base period net income determined under subsection (d)."

Section 435 (e) (2) should be amended by adding the following new subparagraph:

"(H) In the case of a taxpayer who is entitled to the benefits of this subsection under paragraph (1) (C), the average base period net income determined under this subsection shall be either:

"(i) The taxpayer's excess profits net income for the period beginning January 1, 1950, and ending June 30, 1950, multiplied by 2, or

"(ii) The taxpayer's 'weighted excess profits net income' for its first excess profits tax taxable year under this subchapter, determined as provided in subparagraph (E);

whichever results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed."

Exhibit 4

Specific Relief Formula for Extraordinary Growth

PROPOSAL A

Tests.—Taxpayer experienced extraordinary growth during the base period as evidenced by the fact that—

(1) Twice taxpayer's net sales for the period January 1, 1950 to June 30, 1950 is 50 percent or more in excess of the average for 1946 and 1947; and

(2) During 1946 to 1949 taxpayer (i) doubled its productive capacity, or (ii) increased its productive capacity by 50 percent or more and the adjusted basis of its facilities by 50 percent or more, or (iii) doubled the unadjusted basis of its facilities; and

(3) Either (i) twice taxpayer's excess profits net income for January 1, 1950, to June 30, 1950, or (ii) its "weighted excess profits net income" for its first Excess Profits Tax taxable year, is 200 percent or more in excess of its average base period net income.[1]

Credit.—Eighty-five percent of taxpayer's excess profits net income for the period July 1, 1949 to June 30, 1950, such excess profits net income being the sum of:

(1) Taxpayer's "weighted excess profits net income" for the 6 months beginning January 1, 1950, and ending June 30, 1950; and

(2) A substitute excess profits net income for the 6 months beginning July 1, 1949, and ending December 31, 1949, computed by applying to the average of taxpayer's total assets at the end of each month during the period July 1, 1949, to December 31, 1949, its rate of return for the period January 1, 1950, to June 30, 1950.

Test (1) is the same as the sales test of the present growth formula for the new product corporation (sec. 435 (e) (1) (B) (i).) Test (2) is similar to the capacity tests of section 444. Test (3) is similar to the income test of the change in products relief provision, section 443 (a) (3), but the percentage increase in income is made more stringent by increasing it from 25 to 200 percent.

The credit under the present growth formula for the calendar year taxpayer is 40 percent of 1950 income plus 50 percent of 1949 income. The proposed credit is the same for the period January 1, 1950, to June 30, 1950. A substitute excess profits net income is necessary for the period July 1, 1949, to December 31, 1949, however, since 1949 would not ordinarily be a normal year for the taxpayer experiencing extraordinary growth. This substitute net income would be computed by multiplying the average of taxpayer's total assets at the end of each month during the period January 1, 1949, to December 31, 1949, by its rate of return upon total assets for the period January 1, 1950, to June 30, 1950. This rate of return would be determined by dividing taxpayer's "weighted excess profits net income" for the period January 1, 1950, to June 30, 1950, by the average of its total assets at the end of each month during such period.

APPENDIX

PROPOSAL A—PROPOSED AMENDMENT PROVIDING ADDITIONAL FORMULA FOR EXTRAORDINARY GROWTH

Section 435 (e) (1) should be amended by adding the following new subparagraph:

"or,

"(C) (i) the taxpayer's net sales for the period beginning January 1, 1950, and ending June 30, 1950, when multiplied by 2, equals or exceeds 150 per centum of its average net sales for the calendar years 1946–47, as provided in subparagraph (B) (i); and

"(ii) the taxpayer during its base period made an addition or additions to its facilities or replaced all or a part of its existing facilities, and as a result of such additions or replacements:

"(I) its capacity for production or operation on the last day of its base period was 200 per centum or more of its capacity for production or operation on the day prior to the beginning of its base period, or

"(II) (A) its capacity for production or operation on the last day of its base period was 150 per centum or more of its capacity for production or operation on the day prior to the beginning of its base period, and (B) the adjusted basis for determining gain upon sale or exchange of its

[1] "Weighted excess profits net income" for the calendar year 1950, is 80 percent of the excess profits net income, and varying greater and lesser percentages in the case of fiscal years (sec. 435 (e) (2) (E)).

total facilities on the last day of its base period was 150 per centum or more of the adjusted basis for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of its base period, or

"(III) the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the last day of its base period was 200 per centum or more of the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of its base period; and

"(iii) the taxpayer's (I) excess profits net income for the period beginning January 1, 1950, and ending June 30, 1950, multiplied by 2, or (II) the taxpayer's 'weighted excess profits net income' for its first excess-profits tax taxable year under this subchapter, determined as provided in paragraph (2) (E), equals or exceeds 300 per centum of the taxpayer's average base period net income determined under subsection (d)."

Section 435 (e) (2) should be amended by adding the following new subparagraph:

"(H) In the case of a taxpayer who is entitled to the benefits of this subsection under paragraph (1) (C), the average base period net income shall be computed as follows:

"(i) By determining in the manner provided by subparagraph (E), the excess profits net income for each of the 6 months in the period beginning January 1, 1950, and ending June 30, 1950.

"(ii) By computing the aggregate of the excess profits net income for each such month.

"(iii) By determining the average of taxpayer's total assets as of the end of each month during the period beginning January 1, 1950, and ending June 30, 1950.

"(iv) By dividing the amount ascertained under subparagraph (ii) by the amount ascertained under subparagraph (iii).

"(v) By determining the average of taxpayer's total assets as of the end of each month during the period beginning July 1, 1949, and ending December 31, 1949.

"(vi) By multiplying the amount determined under subparagraph (v) by the rate of return determined under subparagraph (iv).

"(vii) By adding to the amount ascertained under subparagraph (ii) the amount ascertained under subparagraph (vi)."

Exhibit 5

Specific Relief Formula for Extraordinary Growth

PROPOSAL B

Tests.—Taxpayer experienced extraordinary growth during the base period as evidenced by the fact that:

(1) Twice taxpayer's net sales for the period January 1, 1950, to June 30, 1950, is 50 percent or more in excess of the average for 1946 and 1947; and

(2) During 1946 to 1949 taxpayer (i) doubled its productive capacity, or (ii) increased its productive capacity by 50 percent or more and the adjusted basis of its facilities by 50 percent or more, or (iii) doubled the unadjusted basis of its facilities; and

(3) Either (i) twice taxpayer's excess profits net income for January 1, 1950, to June 30, 1950, or (ii) its "weighted excess profits net income" for its first excess profits tax taxable year, is 200 percent or more in excess of its average base period net income.[1]

Credit.—Eighty-five percent of either: (1) twice taxpayer's excess profits net income for January 1, 1950, to June 30, 1950, or (2) its "weighted excess profits net income"[1] for its first Excess Profits Tax taxable year, at the taxpayer's election.

This formula is based on tests similar to those already adopted, and could be made effective by simple amendments to section 435. Test (1) is the same as the sales test of the present growth formula for the new product corporation, sec. 435 (e) (1) (B) (i). Test (2) is similar to the capacity tests of section 444. Test (3) is similar to the income test of the change in products relief provision, section 443 (a) (3), but the percentage increase in income is made more stringent by increasing it from 25 to 200 percent.

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[1] "Weighted excess profits net income" is 80 percent of the excess profits net income for the calendar year 1950, and varying greater and lesser percentages in the case of fiscal years (sec. 435 (e) (2) (E)).

APPENDIX

PROPOSAL B—PROPOSED AMENDMENT PROVIDING ADDITIONAL FORMULA FOR EXTRAORDINARY GROWTH

Section 435 (e) (1) should be amended by adding the following new subparagraph:

"or,

"(C) (i) the taxpayer's net sales for the period beginning January 1, 1950, and ending June 30, 1950, when multiplied by 2, equals or exceeds 150 per centum of its average net sales for the calendar years 1946–47, as provided in subparagraph (B) (i); and

"(ii) the taxpayer during its base period made an addition or additions to its facilities or replaced all or a part of its existing facilities, and as a result of such additions or replacements:

"(I) its capacity for production or operation on the last day of its base period was 200 per centum or more of its capacity for production or operation on the day prior to the beginning of its base period, or

"(II) (A) its capacity for production or operation on the last day of its base period was 150 per centum or more of its capacity for production or operation on the day prior to the beginning of its base period, and (B) the adjusted basis for determining gain upon sale or exchange of its total facilities on the last day of its base period was 150 per centum or more of the adjusted basis for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of its base period, or

"(III) the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the last day of its base period was 200 per centum or more of the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of its base period; and

"(iii) the taxpayer's (I) excess profits net income for the period beginning January 1, 1950, and ending June 30, 1950, multiplied by 2, or (II) the taxpayer's 'weighted excess profits net income' for its first excess profits tax taxable year under this subchapter, determined as provided in paragraph (2) (E), equals or exceeds 300 percent of the taxpayer's average base period net income determined under subsection (d)."

Section 435 (e) (2) should be amended by adding the following new subparagraph:

"(H) In the case of a taxpayer who is entitled to the benefits of this subsection under paragraph (1) (C), the average base period net income determined under this subsection shall be either—

"(i) The taxpayer's excess profits net income for the period beginning January 1, 1950, and ending June 30, 1950, multiplied by 2; or

"(ii) The taxpayer's 'weighted excess profits net income' for its first excess profits tax taxable year under this subchapter, determined as provided in subparagraph (E);

whichever results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed."

Senator BYRD. Mr. Seghers. (No response.)

Mr. Clarence J. Dixon.

Will you please identify yourself?

STATEMENT OF CLARENCE J. DIXON, CADILLAC, INC., HOLLYWOOD, CALIF.

Mr. DIXON. Mr. Chairman and gentlemen: My name is Clarence J. Dixon, Cadillac dealer, Hollywood, Calif.

Senator MILLIKIN. Senator Nixon stated his desire to be here, and was here for a while, but he was unavoidably detained. He has shown an interest in your testimony, and will be back.

Mr. DIXON. Thank you.

Gentlemen, first allow me to thank you for the opportunity to appear before this committee with what I feel is an honest and fair plea for relief from the present excess-profits-tax law.

In doing so, I do not want you to receive the impression this is strictly a personal or unusual problem, because I know there are many others facing similar situations, but probably not to the same extent as my case.

Over 35 years ago at the age of 16, I graduated from high school and immediately went to work as an errand boy for the Don Lee & Hillcrest Motor Co. in California. I was continually employed by them in various capacities until November 1, 1950. On that date, through a series of events, including the death of one of the principal owners, I was able to purchase for myself, mostly on borrowed money, the automobile franchise in Hollywood, which I managed for the former owners for many years.

It was, of course, something I had looked forward to all my life, as I am sure you can appreciate, and I was very happy with this new enterprise for about 2 months until I learned just how the excess-profits-tax bill, passed by the Congress, late in 1950, affected my operation.

I was under the impression that an excess profits tax law was in effect an instrument to prevent any business from making more profit in a period of emergency such as we now have, than would be the case in normal peacetimes and I, of course, assumed that, when taking over a going business, that had been in existence for years, I would naturally take over its normal tax base that the former owners would use, were they still in business.

You can appreciate the shock it was to me to learn that under the new law my profit base was reduced to a figure just a shade over 10 percent of what it would have been for the old owners.

Reduced to figures, the business under my management had established a base of $247,000 for the three average years from 1946 through 1949, whereas, my present base is $30,000, which, incidentally, is less than 1 percent of my average yearly sales.

I would like you to keep in mind that this condition exists while I am selling exactly the same products to the same customers, from the same location with the same personnel, under the same management that has existed for many years.

Senator MILLIKIN. Is yours an individual company, or a corporate business?

Mr. DIXON. It had, of necessity, to be a corporation, Senator.

Senator MILLIKIN. And your predecessor——

Mr. DIXON. Was a corporation.

I think I will cover the question you have in mind a little further along here.

The only change has been my name over the door in place of that of the original owners.

That may answer your question.

When purchasing this business, I was obliged to purchase assets rather than stock, due principally to the fact that the original corporation owned five stores, all of which were sold to five separate persons. In purchasing these assets, I also assumed all of the liabilities of the original firm; in fact, the only item that has been changed is the excess-profits-tax base.

I would like to add that the State of California recognized this condition to the extent that they passed on to me the unemployment insurance tax rate established by the original company, rather than make me establish a rate based on experience over a period of years.

One last item, and that is with reference to the actual tax rate under which I am operating.

Under the present law, as soon as I reach a profit figure of $30,000, any additional is taxed at the rate of 77 percent, which, added to our California tax rate of 4 percent, does not leave much out of the dollar for me to use to pay off the business.

By comparison, I would like to call your attention to the fact that other dealers who are my competitors, many of whom have been in business a comparatively short length of time, are operating under a 47 percent maximum tax, which, to me, does not make good sense.

Their tax, I think, is surely high enough, if not too high, particularly for an industry that cannot possibly be helped by war or emergency conditions, but rather, can be very seriously hurt if car production is further curtailed. If my reasoning is sound, and you will agree with it, I hope that something can and will be done in the new law that is now being considered that will correct what I believe to be a very major inequality.

Thank you.

Senator KERR. Is not your taxation under the present law limited to 60 percent of your profits?

Mr. DIXON. 62 percent, after you reach a certain figure, Senator.

Senator KERR. Pardon me?

Mr. DIXON. It has a maximum of 62 percent. But you have to reach that figure before it drops to the 62 percent.

Senator KERR. You are addressing yourself to the new law when you saw that the 77 percent would apply?

Mr. DIXON. No. As soon as we reach our normal tax credit of $30,000, any additional profits are taxed at the rate of 77 percent. When you reach a figure where the 77 percent is higher than a maximum 62 percent over-all, then you drop to the 62 percent.

Senator KERR. You mean 62 percent of your total profits?

Mr. DIXON. That is right.

But until you reach that point where the——

Senator KERR. But your over-all tax cannot be above 62 percent of your profits now?

Mr. DIXON. That is right.

Senator WILLIAMS. You are in the same classification now as a new corporation?

Mr. DIXON. Correct.

Senator BYRD. On part of the income you will pay more than 62 percent?

Mr. DIXON. That is right.

Senator BYRD. But the average over-all cannot be more than 62 percent?

Mr. DIXON. That is right.

Senator KERR. While he may pay a greater percent on part of it, there is another part of it that pays enough less percent that his over-all tax under the present law cannot exceed 62 percent of his entire profits.

Senator WILLIAMS. Do you not have an alternative proposal, instead of using your capital as a base, like a new industry, that you can take the profits that are normal to the industry, as an alternative proposal?

Is that not allowed, Mr. Stam? Cannot the average earnings that are normal to the industry be made applicable for a base?

Mr. STAM. That is a provision that would apply to a new corporation, where you can take the industry rate.

Senator WILLIAMS. That is his situation.

Mr. STAM. That would be his situation. But what he is concerned with is this: I think that he wants to take the base period experience of the company that he bought.

Senator WILLIAMS. Yes; I understand that.

Mr. STAM. That is his position, and I think that the problem there is that he bought the assets but did not buy the stock, and in addition to that the problem is, what sort of credit does the old company get? The old company was not dissolved, because he bought the assets.

The old company, of course, is entitled to its old credit, and in framing the excess profits tax last year one of the things that seemed to worry the committee, was whether or not there would be a double credit, that is, whether the old credit will get that credit and the new company get the credit.

And it is something that we were not able to work out in the limited time that we had the excess profits tax up. But there is a problem there as to whether both companies should get a duplicate credit.

Mr. DIXON. Mr. Stam, I might add there, in this particular case the old company cannot possibly use all of the credit, because there is one store left out of five, and he cannot possibly use it.

I mean, it is lying there going to waste, whereas, in my case and the three other stores that were sold under similar conditions, they are operating just as if they were brand new companies that had never been in business before.

From the standpoint of competition, of course, I think that you can see that we are in a very unfavorable position. We are operating with everything exactly the same as the man down the street, until we reach the point of Federal taxes.

When we reach that point, he has a distinct advantage over us.

Mr. STAM. That is right.

Senator MILLIKIN. Does your demand for Cadillacs exceed the supply?

Mr. DIXON. Yes; it does, Senator, fortunately.

Senator MILLIKIN. Do you engage in the second-hand business?

Mr. DIXON. Yes.

Senator MILLIKIN. Are you in the general servicing business, also?

Mr. DIXON. Yes, sir. My business has for the last 4 or 5 years averaged over $3,000,000 a year total sales, including service, parts, and new and used cars.

Now, I am operating under conditions where, when we reach the point of 1 percent of total sales, everything then immediately is excess profits.

Senator BYRD. Under this new bill, would you reach the 70-percent limit? Have you studied the provisions?

Mr. DIXON. I think so, Senator. I feel certain we would. Of course, our business is quite uncertain.

Senator KERR. The new bill does not change the credit. If just increases the rate.

Mr. DIXON. And it lowers the credit a bit, too, does it not?

Mr. STAM. It raises the over-all from 62 percent to 70 percent.

Senator BYRD. And you would be in the 70 percent?

Mr. DIXON. That is right, plus the California tax.

Senator KERR. The only change that would be in his situation would be that it would be worse.

Mr. DIXON. Definitely.

Senator KERR. And I presume that before this happened, he did not think it could get worse?

Mr. DIXON. I did not think last November 1 that this could happen, Senator, I can assure you.

Senator BYRD. I see.

Thank you very much, Mr. Dixon.

Mr. DIXON. Thank you, gentlemen.

Senator BYRD. Your full statement will be put into the record, Mr. Dixon.

Mr. DIXON. Thank you, sir.

(The prepared statement of Mr. Dixon is as follows:)

CLARENCE DIXON CADILLAC, INC.,
Hollywood, Calif., July 23, 1951.

The SENATE FINANCE COMMITTEE,
Senate Building, Washington, D. C.

GENTLEMEN: First allow me to thank you for the opportunity to appear before this committee with what I sincerely feel is an honest and fair plea for relief from the present excess-profits tax law. In doing so, I do not want you to receive the impression this is strictly a personal or unusual problem, because I know there are many others facing similar situations, but probably not to the same extent as my case.

Over 35 years ago, at the age of 16, I graduated from high school and immediately went to work as an errand boy for the Don Lee & Hillcrest Motor Co. in California. I was continually employed by them in various capacities until November 1, 1950. On that date, through a series of events, including the death of one of the principal owners, I was able to purchase for myself, mostly on borrowed money, the automobile franchise in Hollywood, which I managed for the former owners for many years. It was, of course, something I had looked forward to all my life, as I am sure you can appreciate, and I was very happy with this new enterprise for about 2 months until I learned just how the excess-profits-tax bill, passed by the Congress late in 1950, affected my operation.

I was under the impression that an excess-profits-tax law was in effect an instrument to prevent any business from making more profit in a period of emergency such as we now have than would be the case in normal peacetimes and I of course assumed that when taking over a going business that had been in existence for years, I would naturally take over its normal tax base that the former owners would use were they still in business. You can appreciate what a shock it was to me to learn that, under the new law, my profit base was reduced to a figure just a shade over 10 percent of what it would have been for the old owners. Reduced to figures, the business under my management had established a base of $247,000 for the three average years from 1946 through 1949, whereas my present base is $30,000, which, incidentally, is less than 1 percent of my average yearly sales. I would like you to keep in mind that this condition exists while I am selling exactly the same products to the same customers, from the same location, with the same personnel, under the same management that has existed for many years. The only change has been my name over the door in place of that of the original owners.

When purchasing this business, I was obliged to purchase assets rather than stock, due principally to the fact the original corporation owned five stores, all of which were sold to five separate persons. In purchasing these assets, I also assumed all of the liabilities of the original firm; in fact, the only item that has been changed is the excess-profits-tax base. I would like to add that the State of

California recognized this condition to the extent they passed on to me the unemployment insurance tax rate established by the original company, rather than make me establish a rate based on experience over a period of years.

One last item and that is with reference to the actual tax rate under which I am operating. Under the present law, as soon as I reach a profit figure of $30,000 any additional is taxed at the rate of 77 percent, which, added to our California tax rate of 4 percent, does not leave much left out of the dollar for me to use to pay off the business. By comparison, I would like to call your attention to the fact that other dealers who are my competitors, many of whom have been in business a comparatively short length of time, are operating under a 47 percent maximum tax, which to me does not make good sense. Their tax, I think, is surely high enough, if not too much so, particularly for an industry that cannot possibly be helped by war or emergency conditions, but rather can be very seriously hurt if car production is further curtailed. If my reasoning is sound and if you agree with it, I hope something can and will be done in the new law now being considered that will correct what I believe to be a very major inequality.

Respectfully submitted.

CLARENCE J. DIXON.

MEMORANDUM RE AMENDING THE EXCESS-PROFITS-TAX LAWS TO PROVIDE FOR THE TRANSFER OF AN EXCESS-PROFITS-TAX CREDIT BASED UPON INCOME (OR A PORTION THEREOF), BY ONE TAXPAYER TO ANOTHER, IN CONNECTION WITH THE TRANSFER OF SUBSTANTIALLY ALL (OR A SEVERABLE PORTION) OF THE ASSETS AND BUSINESS OF THE TRANSFEROR

The excess-profits-tax laws in effect from 1940 through 1945 made no general provision for the transfer of an excess-profits-tax credit based upon income (or of any part thereof) by one corporate taxpayer to another corporate taxpayer in connection with the transfer of the assets and business (or a severable portion thereof) of the former. They did, however, provide that an acquiring corporation might include in its excess-profits-tax credit based upon income, the earnings experience of the business taken over, in connection with transactions qualifying as tax-free reorganizations under section 112 of the Internal Revenue Code, under certain limiting conditions.

The Excess Profits Tax Act of 1950 continues the general plan of the earlier acts, and a new provision covers certain transactions in which only a part of the business of the predecessor unit is taken over. Eligible transactions involving the taking over of only part of a business are restricted to those of the type defined in Internal Revenue Code 112 (b) (5), namely, those in which "property is transferred to a corporation by one or more persons solely in exchange for stock and securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; * * *." (Sec. 112 (b) (4) transactions are likewise eligible, but since these involve exchanges of securities for securities in a reorganization, they probably are not of interest in connection with sales of part of the business.) It might be contended that Internal Revenue Code 461 (a) (1) (E), the 1950 provision for transactions described in section 112 (c) (5), can be used in typical cases of a sale of part of the business to permit the purchaser to make use of the earnings experience of the seller insofar as that experience is based upon, or allocated to, the assets sold. If the statutory provisions are applied literally it would for example be possible for a corporation to transfer all the properties of a branch operation to a new corporation in exchange for all the stock of the new corporation and immediately thereafter to sell the stock with the result that the new corporation would have an excess-profits-tax credit based upon the earnings experience of the branch or the portion of the earnings experience of the seller allocated to the branch. The possible barrier across this route is the rule engrafted in section 112 by the United States Supreme Court that a transaction to qualify under that section must involve a continuity of proprietary interest held by the transferor in the business of the transferee.

It is clear that the transaction described would qualify were it not for the immediate sale of the stock, such sale being made as part of the original plan. Whether the judicial rule referred to would be applied to deprive the transaction of its qualification upon the ground that the sale of the stock destroyed the continuity of interest is not certain from the quick examination of the cases and other writings on the subject. As a matter of statutory construction it seems that the continuity of interest rule should not apply to this particular subsection of section 112 inasmuch as this subsection contains its own definition of circumstances which must exist following the transfer, namely, that "immediately after the exchange" the transferor must own at least 80 percent of the voting stock and 80 percent of every other class of stock of the transferee. The subsections involved when the continuity of interest rule has been applied do not contain a similar provision.

Assuming that section 461 (a) (1) (E) cannot be used because of possible application of the continuity of interest rule, or for any other reason, or assuming a transaction already completed in which assets have been sold and a new corporation formed by the purchaser (rather than the reverse order outlined above), an amendment to the Internal Revenue Code would be required to give the transferee a portion of the earnings experience of the transferor.

The objective of the amendment would be to include among the definitions of acquiring corporations provided in section 461 (a) of the code any successor to the business, or a distinct part of the business of a corporation, partnership, or sole proprietorship. The problem of definition is to make sure that the purchaser is a genuine successor to the business rather than the purchaser merely of assets to be used in some other business. There is also the procedural problem of ascertaining the portion of the transferor's earnings experience which is to be transferred. This probably requires eligibility to be restricted to transactions in which the business transferred is either the entire business of the transferor (in which case one of the existing subsections of sec. 461 (a) may be applicable) or a clearly identifiable and severable portion of the business. The statute under consideration is so prolix (approximately 41,000 words in the Excess Profits Tax Act, of which over 9,000 are in part II devoted to acquiring corporations) that it is especially difficult to be sure that any suggested language adequately covers all possibilities while at the same time being sufficiently descriptive to minimize the necessity for the exercise of administrative discretion or judicial interpretation.

Recognizing, therefore, the need for careful consideration by many people, the following is suggested as an approach to the desired amendment:

To section 461 (a) (1), add a new subsection (F) so that, insofar as is pertinent, the definition of an acquiring corporation will read as follows:

"For the purposes of this part—

"(a) Acquiring corporation: The term 'acquiring corporation' means—

"(1) A corporation which has acquired—

* * * * *

"(F) Substantially all the properties 'used immediately prior to the acquisition,' (1) in the business of another corporation or partnership, or (2) in a severable portion of the business of another corporation or partnership, in a transaction not otherwise described in this subsection, for the purpose of continuing such business or such severable portion."

Other sections and subsections, including subsection 461 (f) (which includes in the term "partnership" a sole proprietorship), will then have to be amended to add reference to the new subsection 461 (a) (1) (F).

The definition of "component corporation" in section 461(b) should have added to it a new subsection (7) as follows:

"(7) In the case of a transaction specified in subsection (a) (1) (F), the partnership or corporation whose properties were acquired."

In this memorandum reference is made to "substantially all the properties" of the transferor, even though presumably the new subsection would not be used in the event of the transfer of substantially all the properties of the business for the reason that one of the existing subsections should be applicable. The language does no harm, however, and has certain advantages, in that it follows the form of existing subsection (E), which likewise presumably will be used only in transactions in which less than all the assets of the transferor are involved, and may possibly pick up some transactions not otherwise covered. The restriction to properties "used immediately prior to the acquisition" in the business of the transferor is intended to confine eligibility to those transactions in which there is an actual going business which is the subject of the transfer. The term "severable portion" has the disadvantage that it may require interpretation of the word "severable," but that does not seem likely to pose much of a problem since severability is something which should be capable of demonstration and the concept of severability is a necessary element of the concept of continuation of the business. The parenthetical phrase "in a transaction not otherwise described in this subsection," is copied from the existing subsection (E) and means that if a transaction qualifies under any other part of subsection 461 (a), or at least under any other part of 461 (a) (1), it will be handled under such other part and hence not subject to the many complicated rules which follow in later sections of the code governing the allocation of the earnings experience to the portion of the assets transferred. (All subsections of 461 (a), other than 461 (a) (1) (E) and the proposed new 461 (a) (1) (F), involve transfers of the entire assets and hence the entire earnings experience of the transferor.) The final phrase "for the purpose of continuing such business or such severable portion" is necessary to confine eligibility to those transactions in which there is a genuine succession of the business. The disadvantage of this phrase is that it requires a subjective test to determine "purpose." An objective test is always preferable but it is difficult to devise one to fit the circumstances. Actual continuation of the business without time limitation cannot be required because that would require, each year, a reexamination of the transferee's right to use its predecessor's earnings experience. Continuation of the business for a specified time is a possibility but leads to complications almost as serious as continuation of the business without time limit.

In view of the fact that the existing section 461 (a) (1) (E) includes, among eligible transactions, some transactions in which only part of the assets of the transferor are involved, it is not necessary, because of the proposed amendment enlarging eligibility provisions, to add anything further covering allocation of the earnings experience of the transferor. The existing statute provides the following methods of allocation of the transferor's earnings experience between the transferor and the transferee:

(1) In proportion to the value of the assets retained and the assets transferred.

(2) In proportion to the values of assets retained and transferred as agreed upon between parties with the approval of the Secretary of the Treasury.

(3) By allocating to the transferee the actual earnings experience of the particular assets transferred as agreed upon between the parties with the approval of the Secretary of the Treasury.

Draft of Proposed Amendment to Excess Profits Tax Act of 1950 Being Subchapter (D) of Chapter (1) of the Internal Revenue Code

Section 1. Section 461 (a) (1) of the Internal Revenue Code is amended by inserting after subsection (E) a new subsection (F) as follows:

"(F) Substantially all the properties used immediately prior to the acquisition, (1) in the business of another corporation or partnership, or (2) in a severable portion of the business of another corporation or partnership, in a transaction not otherwise described in this subsection for the purpose of continuing such business or such severable portion."

Sec. 2. Section 461 (b) of the Internal Revenue Code is amended by adding after subsection (6) a new subsection (7) as follows:

"(7) In the case of a transaction specified in subsection (a) (1) (F), the partnership or corporation whose properties were acquired."

Sec. 3. Sections 461 (c) (3), 461 (c) (4), and 461 (d) are amended by inserting after the words "subsection (a) (1) (E)" wherever such words appear, the following: "or subsection (a) (1) (F)."

Sec. 4. Section 461 (f) of the Internal Revenue Code is amended by inserting after the words "sections 461 (a) (1) (D)," the following: "461 (a) (1) (F)."

Sec. 5. Sections 462 (c) (1), 462 (c) (2), 462 (d) (1) (A), 462 (d) (1) (B), 462 (e) (1), 462 (e) (2), 462 (g) (2) (A), 462 (g) (2) (B), 462 (i), 463 (a) (1), 463 (a) (2), 463 (a) (3), 463 (a) (4), 463 (a) (5), 463 (a) (6), 463 (a) (8), 463 (a) (9), 463 (a) (10), 463 (a) (12), 464 (a), 464 (b) of the Internal Revenue Code are amended by inserting after the words "section 461 (a) (1) (E)" wherever they appear the following: "or section 461 (a) (1) (F)."

Sec. 6. The amendments made by this act shall be effective for taxable years ending after June 30, 1950.

Senator Byrd. Mr. Phil Hall, please.

Mr. Hall, will you please identify yourself.

STATEMENT OF PHIL HALL, PHIL HALL BUICK CO. HOLLYWOOD, CALIF.

Mr. HALL. I am Phil Hall of the Phil Hall Buick Co., Hollywood, Calif.

First, I wish to thank you for the opportunity of coming here.

Briefly, my problem is this: 28 years ago I started to work for the Howard Motor Co. in Hollywood, selling Buicks. Three years later I was made sales manager and 6 years after that manager, which position I held for 18 years, or until last August, when I was able to fulfill my lifetime ambition of becoming the Buick dealer in Hollywood, largely on borrowed capital, my personal interest being less than 25 percent.

Since that time, as you know, the excess-profits tax was enacted, which has seriously jeopardized my position. In saying this, I am fully aware of the emergency and the need for everyone to sacrifice from every standpoint, including, of course, the financial one.

But that is not my problem. Rather it is the problem of surviving in a competitive business when the excess-profits tax law gives most of my competitors a distinct trading advantage.

As you know, in the retail automobile business——

Senator KERR. Did you tell us where you were from, Mr. Hall?

Mr. HALL. Yes, sir, from Hollywood, Calif.

Senator KERR. Very well.

Mr. HALL. As you know, in the retail automobile business, used-car allowance is a very material factor, and it is clear that the most efficiently managed business is in the best trading position, provided, and this is most important, that his tax liability is relatively the same.

Conversely, recognizing that a dealer's tax liability is in the nature of an expense item, a dealer cannot possibly meet a competitor's used-car allowance if his taxes are relatively higher.

To be specific, the expenses of my business are based on so much per new car sold for heat, light, gas, telephone, rent, insurance, advertising, and so forth.

But when I come down to the item of Federal taxes, I am lost, and I cannot compete because they pay taxes on one basis, having been in business during the base period of 1946–49, and I pay taxes on another.

To further emphasize my point, this is a 33-year-old business, doing $4,500,000 gross annually. The present tax base is $52,000, which allows us——

Senator MILLIKIN. Did you buy the company or did you buy the assets?

Mr. HALL. I bought the assets, Senator Millikin.

Senator KERR. You are in the same position exactly as the man who was just ahead of you?

Mr. HALL. Yes, Senator, brought about by the same conditions, with the passing of Mr. Lee and Mr. Howard out there, at about the same time, and they broke up the distributorship so that we had a chance to have these dealerships after having worked there all our lives.

Senator BYRD. How much of an increase in taxes do you pay by reason of the excess-profits tax?

Mr. HALL. We pay about six times.

In other words, our base is about one-sixth of what it would be under our predecessor company.

Senator BYRD. I understand that. How much more in dollars do you pay than under the ordinary tax bill? In other words, what does the excess-profits tax cost you?

Mr. HALL. The difference between 47 and 62, as a maximum. So, it has an effect that we would be paying about half again as much.

Senator TAFT. Why half again as much?

Mr. HALL. The difference between 62 and 47 percent. I do not know the exact percentage that would be.

Senator TAFT. That is about a third again as much.

Mr. HALL. About a third, yes.

Senator BYRD. You are paying about $15,000 more taxes?

Senator KERR. How much of an increase—how much more taxes are you paying than the man would be paying if he were still operating?

Is that the question? That is what I want to know.

Senator MILLIKIN. If he has the same profit.

Senator KERR. Yes.

Mr. HALL. We will say if we had a $100,000 profit, we would pay $62,000 where he paid $47,000.

Senator KERR. I can figure that out.

Mr. HALL. That is the figure.

Senator BYRD. You are assuming that the other fellow has no excess-profits tax to pay?

Mr. HALL. The reason for that, of course, is during our base, 1946 through 1949, the earnings during this period now do not begin to come up with what the normal earnings were during that period—the base period.

Senator TAFT. What is your best formula under the bill?

Mr. HALL. Our best formula is the industry experience, but unfortunately——

Senator TAFT. Is that better than 12 percent on your investment?

Mr. HALL. Yes, sir. But unfortunately, that includes service stations, used-car operations, and businesses that perhaps were not as well managed as others.

Senator TAFT. And how is that figured out? Is that figured out by the Treasury?

Mr. HALL. Yes, sir.

Senator TAFT. Well, they give you that figure, is that right?

Mr. HALL. Yes, sir.

Senator TAFT. They give you the figure for what they say is your industry?

Mr. HALL. Yes, sir.

Senator TAFT. And they arbitrarily decided—I do not mean arbitrarily, but somebody has to decide—what shall be included in your industry?

Mr. HALL. That is right. They decided that there would be service stations and tire dealers and used-car dealers and then other franchises that perhaps were not as desirable.

Senator TAFT. Offhand, I should think that that would be a different classification from those who sell automobiles.

It is in the law itself. Mr. Stam points out that it is in the law itself. So we would have to change it.

Automobile repair services and garages, everything connected with automobiles, presumably is in one heading.

Mr. HALL. Yes, sir.

Senator BYRD. And under the new bill, the pending bill, you would probably pay 70 percent?

Mr. HALL. Yes, sir.

Senator TAFT. Of course, this is not quite necessarily so. Your own figures would throw everything you make into excess profits?

Mr. HALL. No; not that. You see, our business——

Senator TAFT. I mean, after all, you got 12 percent on what you put in, anyway, before the base?

Mr. HALL. Senator Taft, we are able to make a little over 1 percent on our gross sales at the present time. In other words, our tax base is $51,000 and our gross sales are $4,500,000. So you can see that that is slightly over 1 percent.

Senator TAFT. Your gross sales——

Mr. HALL. Annually; yes, sir.

Senator TAFT. What is the $51,000?

Mr. HALL. Our tax base, our excess-profits tax base.

Senator KERR. In other words, you begin to pay excess profits when you get above an earnings figure of $51,000?

Mr. HALL. Yes, sir.

At this particular time, as Clarence Dixon testified just before me, we pay at this moment 77 percent. Now, I know that as soon as you reach a maximum, you go back to 62 percent, after you go through that experience. But at this particular time, as our statement is set up, 77 percent comes off for the Federal and 4 percent for the California ta...

So, it is 81 percent, or a total of 19 cents out of each dollar is left.

Senator KERR. That is, above your base exemptions?

Mr. HALL. Yes, sir, because of course, we use that up the first part of the year. It is purely a psychological effect, but it is a little discouraging when it comes along.

Senator MILLIKIN. Is the California tax a flat tax?

Mr. HALL. Yes, sir.

Senator KERR. Do you not also get a deduction for that before you figure your Federal tax?

Mr. HALL. I am not a tax man, but I would be of the opinion that you would.

So, in effect, it would not be that high. I can see the point.

Senator BYRD. It is counted as an expense, the State tax.

Mr. HALL. May I continue?

Senator BYRD. Yes.

Mr. HALL. If we were allowed to use our predecessor tax base, it would be approximately $300,000.

Now, to check this amount from another angle, the figures recently released by the National Automobile Dealers Association show that in 1949——

Senator MILLIKIN. May I interrupt to ask, did you take over the whole business of your predecessor, as in the case of the preceding witness, or a part of the operation?

Mr. HALL. I took over the Hollywood operation. In the over-all predecessor company, there were about five dealers. But at the present time, there is no tax base being used, because that corporation was dissolved.

Senator TAFT. You say that he had a tax base of $300,000 a year. How did you get the business? I am sorry, I missed that. Did you buy it?

Mr. HALL. Yes, sir. I bought the assets, largely with borrowed money.

My personal interest was less than 25 percent.

Senator TAFT. For how much, for a business making $300,000 a year? I do not want to embarrass you.

Senator BYRD. He did not buy all the business.

Mr. HALL. No, I bought just one of the stores.

Senator BYRD. What percentage of the business did you buy?

Senator TAFT. Obviously, it is less than $400,000 for a business earning $300,000, because, otherwise, you would have a higher tax base than $51,000.

Senator MILLIKIN. Your point is that you want to be put in the same position as though you were the old business and continuing as the old business?

Mr. HALL. You see, Senator, in effect I established——

Senator MILLIKIN. Is that what you want to do?

Mr. HALL. Yes, sir.

I established the tax base, myself, because I managed the business during the base period and for 15 years before that.

Senator BYRD. What part of the business did you buy? What percentage?

Senator KERR. As I understand it, he bought a 25-percent interest in that one dealership.

Mr. HALL. Yes, sir.

Senator BYRD. You mean, when you bought it out?

Mr. HALL. Of the whole, it would represent about a fifth.

Senator KERR. But that one-fifth had been earning $300,000 a year, as I understand it?

Mr. HALL. That is correct.

I am going to speak about the National Automobile Dealers now.

In 1949, dealerships handling over 300 cars a year had an average earnings of 6.4 on gross sales b[illegible] taxes, and applying that formula to our business—in other wor[illegible]s is an average across the United States, the best of the worst and the worst of the best—we would have a tax base of $290,304. In other words, if we did an average job, that would be our tax base.

I have, of necessity, covered this from my standpoint, and the standpoint of all new retail automobile dealers and you can appreciate that the problem is much more far reaching. Actually, what I am pleading for is equality of treatment for all new businesses, in other words that new businesses forming an important part of our war and peacetime economy may be given the same opportunity to succeed as is given those businesses that are already established.

You know, when I was a little boy in Colorado, my folks took me to a stock show——

Senator MILLIKIN. What part of Colorado?

Mr. HALL. Denver.

Senator KERR. Did you know that the senior Republican member of this committee is from Colorado?

Mr. HALL. The fact of the matter is, I was not born very far from there, in Greeley.

Senator KERR. I think that is very important.

Senator MILLIKIN. It has a more important bearing than you might suspect.

Senator KERR. You do not have any relatives in Oklahoma?

Mr. HALL. As a matter of fact, my father passed on there.

The thing that impressed me most at this stock show was that there was a goat there operating a treadmill to churn butter, and the secret of the success of that goat was to put the hay just at the right place because if you put it too close, the goat ate it, and if you put it too far away, he lost interest and cut down.

So, you have to put the hay just in the right place, where the goat can't get it, and he keeps on working. At least that is the way I see it.

Senator MILLIKIN. You have posed the profound problem which always confronts this committee.

Mr. HALL. To sum it up briefly, gentlemen, we would like to have an amendment, Clarence Dixon and myself, if we could, that would make it possible for us to use our predecessor's tax base.

Senator BYRD. Thank you very much.

Mr. HALL. I appreciate very much having been allowed to come here.

Senator MILLIKIN. Let me ask you this. When you took over that business, you took over the business for better or worse? I mean, it had its own reputation, and I assume that there might have been liabilities involved in taking it over?

Mr. HALL. Yes, sir.

We took over all the liabilities. For instance, any cars, Buicks that had been sold in that area in the preceding several years that would have any service problems of any kind, we took on.

Senator MILLIKIN. It is not in substance as though you were starting a fresh business?

Mr. HALL. No, sir.

Senator MILLIKIN. Whether you liked it or not, you were in real importance the successor of the business that you bought out?

Mr. HALL. That is right. There is only one small technicality, the fact that we did not buy the stock.

Senator MILLIKIN. You were favored with its benefits and favored also with its liabilities?

Mr. HALL. That is right. And the State of California recognized our experience in establishing our rate for the unemployment insurance out there just as they did in Mr. Dixon's case.

Senator BYRD. Thank you very much, Mr. Hall.

Mr. HALL. Thank you.

(The following information was subsequently supplied for the record:)

PHIL HALL BUICK CO.,
Hollywood, Calif., July 25, 1951.

SENATE FINANCE COMMITTEE,
Senate Building, Washington, D. C.

GENTLEMEN: The attached is a summary of my report made today at the hearing on the excess-profits phase of the tax bill.

As mentioned at the hearing, I feel a major inequity exists, which I am sure you will recognize, and sincerely hope it will be corrected in the new bill now being considered. The solution may be a simple amendment to the present law, such as the one I have taken the liberty of preparing for your consideration. I respectfully submit it to you, with a detailed explanation covering the proposed changes.

I earnestly hope the committee will make a favorable report on this proposed amendment.

Respectfully yours,

PHIL HALL.

MEMORANDUM RE AMENDING THE EXCESS-PROFITS-TAX LAWS TO PROVIDE FOR THE TRANSFER OF AN EXCESS-PROFITS-TAX CREDIT BASED UPON INCOME (OR A PORTION THEREOF), BY ONE TAXPAYER TO ANOTHER, IN CONNECTION WITH THE TRANSFER OF SUBSTANTIALLY ALL (OR A SEVERABLE PORTION) OF THE ASSETS AND BUSINESS OF THE TRANSFEROR

The excess-profits-tax laws in effect from 1940 through 1945 made no general provision for the transfer of an excess-profits-tax credit based upon income (or of any part thereof) by one corporate taxpayer to another corporate taxpayer in connection with the transfer of the assets and business (or a severable portion thereof) of the former. They did, however, provide that an acquiring corporation might include in its excess-profits-tax credit based upon income, the earnings experience of the business taken over, in connection with transactions qualifying as tax-free reorganizations under section 112 of the Internal Revenue Code, under certain limiting conditions.

The Excess Profits Tax Act of 1950 continues the general plan of the earlier acts, and a new provision covers certain transactions in which only a part of the business of the predecessor unit is taken over. Eligible transactions involving the taking over of only part of a business are restricted to those of the type defined in Internal Revenue Code 112(b) (5), namely, those in which "property is transferred to a corporation by one or more persons solely in exchange for stock and securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; * * *." (Sec. 112(b) (4) transactions are likewise eligible, but since these involve exchanges of securities for securities in a reorganization, they probably are not of interest in connection with sales of part of the business.) It might be contended that Internal Revenue Code 461(a) (1) (E), the 1950 provision for transactions described in section 112(e) (5), can be used in typical cases of a sale of part of the business to permit the purchaser to make use of the earnings experience of the seller insofar as that experience is based upon, or allocated to, the assets sold. If the statutory provisions are applied literally it would for example be possible for a corporation to transfer all the properties of a branch operation to a new corporation in exchange for all the stock of the new corporation and immediately thereafter to sell the stock with the result that the new corporation would have an excess-profits-tax credit based upon the earnings experience of the branch or the portion of the earnings experience of the seller allocated to the branch. The possible barrier across this route is the rule engrafted in section 112 by the United States Supreme Court that a transaction to qualify under that section must involve a continuity of proprietary interest held by the transferor in the business of the transferee.

It is clear that the transaction described would qualify were it not for the immediate sale of the stock, such sale being made as part of the original plan. Whether the judicial rule referred to would be applied to deprive the transaction of its qualification upon the ground that the sale of the stock destroyed the continuity of interest is not certain from the quick examination of the cases and other writings on the subject. As a matter of statutory construction it seems that the continuity of interest rule should not apply to this particular subsection of section 112 inasmuch as this subsection contains its own definition of circumstances which must exist following the transfer, namely, that "immediately after the exchange" the transferor must own at least 80 percent of the voting stock and 80 percent of every other class of stock of the transferee. The subsections involved when the continuity of interest rule has been applied do not contain a similar provision.

Assuming that section 461 (a) (1) (E) cannot be used because of possible application of the continuity of interest rule, or for any other reason, or assuming a transaction already completed in which assets have been sold and a new corporation formed by the purchaser (rather than the reverse order outlined above), an amendment to the Internal Revenue Code would be required to give the transferee a portion of the earnings experience of the transferor.

The objective of the amendment would be to include among the definitions of acquiring corporations provided in section 461 (a) of the code any successor to the business, or a distinct part of the business of a corporation, partnership, or sole proprietorship. The problem of definition is to make sure that the purchaser is a genuine successor to the business rather than the purchaser merely of assets to be used in some other business. There is also the procedural problem of ascertaining the portion of the transferor's earnings experience which is to be transferred. This probably requires eligibility to be restricted to transactions in which the business transferred is either the entire business of the transferor (in which case one of the existing subsections of sec. 461 (a) may be applicable) or a clearly identifiable and severable portion of the business. The statute under consideration is so prolix (approximately 41,000 words in the Excess Profits Tax Act, of which over 9,000 are in part II devoted to acquiring corporations) that it is especially difficult to be sure that any suggested language adequately covers all possibilities while at the same time being sufficiently descriptive to minimize the necessity for the exercise of administrative discretion or judicial interpretation

Recognizing, therefore, the need for careful consideration by many people, the following is suggested as an approach to the desired amendment:

To section 461 (a) (1), add a new subsection (F) so that, insofar as is pertinent, the definition of an acquiring corporation will read as follows:

"For the purposes of this part—

"(a) Acquiring corporation: The term 'acquiring corporation' means—

"(1) A corporation which has acquired—

* * * * *

"(F) Substantially all the properties 'used immediately prior to the acquisition,' (1) in the business of another corporation or partnership, or (2) in a severable portion of the business of another corporation or partnership, in a transaction not otherwise described in this subsection, for the purpose of continuing such business or such severable portion."

Other sections and subsections, including subsection 461 (f) (which includes in the term "partnership" a sole proprietorship), will then have to be amended to add reference to the new subsection 461 (a) (1) (F).

The definition of "component corporation" in section 461 (b) shall have added to it a new subsection (7) as follows:

"(7) In the case of a transaction specified in subsection (a) (1) (F), the partnership or corporation whose properties were acquired."

In this memorandum reference is made to "substantially all the properties" of the transferor, even though presumably the new subsection would not be used in the event of the transfer of substantially all the properties of the business for the reason that one of the existing subsections should be applicable. The language does no harm, however, and has certain advantages, in that it follows the form of existing subsection (E), which likewise presumably will be used only in transactions in which less than all the assets of the transferor are involved, and may possibly pick up some transactions not otherwise covered. The restriction to properties "used immediately prior to the acquisition" in the business of the transferor is intended to confine eligibility to those transactions in which there is an actual going business which is the subject of the transfer. The term "severable portion" has the disadvantage that it may require interpretation of the word "severable," but that does not seem likely to pose much of a problem since severability is something which should be capable of demonstration and the concept of severability is a necessary element of the concept of continuation of the business. The parenthetical phrase "in a transaction not otherwise described in this subsection," is copied from the existing subsection (E) and means that if a transaction qualifies under any other part of subsection 461 (a), or at least under any other part of 461 (a) (1), it will be handled under such other part and hence not subject to the many complicated rules which follow in later sections of the code governing the allocation of the earnings experience to the portion of the assets transferred. (All subsections of 461 (a), other than 461 (a) (1) (E) and the proposed new 461 (a) (1) (F), involve transfers of the entire assets and hence the entire earnings experience of the transferor.) The final phrase "for the purpose of continuing such business or such severable portion" is necessary to confine eligibility to those transactions in which there is a genuine succession of the business. The disadvantage of this phrase is that it requires a subjective test to determine "purpose." An objective test is always preferable but it is difficult to devise one to fit the circumstances. Actual continuation of the business without time limitation cannot be required because that would require, each year, a reexamination of the transferee's right to use its predecessor's earnings experience.

Continuation of the business for a specified time is a possibility but leads to complications almost as serious as continuation of the business without time limit.

In view of the fact that the existing section 461 (a) (1) (E) includes, among eligible transactions, some transactions in which only part of the assets of the transferor are involved, it is not necessary, because of the proposed amendment enlarging eligibility provisions, to add anything further covering allocation of the earnings experience of the transferor. The existing statute provides the following methods of allocation of the transferor's earnings experience between the transferor and the transferee:

(1) In proportion to the value of the assets retained and the assets transferred.

(2) In proportion to the values of assets retained and transferred as agreed upon between parties with the approval of the Secretary of the Treasury.

(3) By allocating to the transferee the actual earnings experience of the particular assets transferred as agreed upon between the parties with the approval of the Secretary of the Treasury.

DRAFT OF PROPOSED AMENDMENT TO EXCESS PROFITS TAX ACT OF 1950 BEING SUBCHAPTER (D) OF CHAPTER (1) OF THE INTERNAL REVENUE CODE

SEC. 1. Section 461 (a) (1) of the Internal Revenue Code is amended by inserting after subsection (E) a new subsection (F) as follows:

"(F) Substantially all the properties used immediately prior to the acquisition, (1) in the business of another corporation or partnership, or (2) in a severable portion of the business of another corporation or partnership, in a transaction not otherwise described in this subsection, for the purpose of continuing such business or such severable portion."

SEC. 2. Section 461 (b) of the Internal Revenue Code is amended by adding after subsection (6) a new subsection (7) as follows:

"(7) In the case of a transaction specified in subsection (a) (1) (F), the partnership or corporation whose properties were acquired."

SEC. 3. Sections 461 (c) (3), 461 (c) (4), and 461 (d) are amended by inserting after the words "subsection (a) (1) (E)" wherever such words appear, the following: "or subsection (a) (1) (F)."

SEC. 4. Section 461 (f) of the Internal Revenue Code is amended by inserting after the words "sections 461 (a) (1) (D)," the following: "461 (a) (1) (F)."

SEC. 5. Sections 462 (c) (1), 462 (c) (2), 462 (d) (1) (A), 462 (d) (1) (B), 462 (e) (1), 462 (e) (2), 462 (g) (2) (A), 462 (g) (2) (B), 462 (i), 463 (a) (1), 463 (a) (2), 463 (a) (3), 463 (a) (4), 463 (a) (5), 463 (a) (6), 463 (a) (8), 463 (a) (9), 463 (a) (10), 463 (a) (12), 464 (a), 464 (b) of the Internal Revenue Code are amended by inserting after the words "section 461 (a) (1) (E)" wherever they appear the following: "or section 461 (a) (1) (F)."

SEC. 6. The amendments made by this act shall be effective for taxable years ending after June 30, 1950.

Senator BYRD. We will now hear from Senator Warren G. Magnuson, of Washington.

STATEMENT OF HON. WARREN G. MAGNUSON, UNITED STATES SENATOR FROM THE STATE OF WASHINGTON

Senator MAGNUSON. Mr. Chairman, I would like the record to show that Mr. Clarence D. Martin, Jr., is present here today. Dan is an old friend of mine from the State of Washington. He is involved in the same transaction Mr. Hall and Mr. Dixon have been outlining to you. He bought the Cadillac agency in Santa Monica, Calif., and like Mr. Dixon and Mr. Hall took over the assets of the business, which produce an excess-profits base, which was taken by someone else. He is left with the operating advantages, disadvantages, and liabilities of the identical concern operated by the former owners, but with an excess-profits base computed on the standard industry factor. This leaves him at a distinct disadvantage in competing with other agencies in his line of business.

There is a real inequity here that I hope your committee will consider and correct. Thank you, Mr. Chairman, for giving me the opportunity to make these brief remarks.

Senator BYRD. Thank you, Senator Magnuson. We are glad you could be with us.

Mr. Marvin K. Brown?

STATEMENT OF MARVIN K. BROWN, MARVIN K. BROWN CADILLAC-OLDSMOBILE, INC.

Mr. BROWN. Mr. Chairman and members of the Senate Finance Committee, I would like to express my appreciation for this opportunity to come to Washington, and I would like, also, to say that there is quite a similarity in the cases of Mr. Dixon, Mr. Hall, and myself, in that I also bought one of the businesses of the Don Lee Co.

Senator BYRD. You bought the San Diego business?

Mr. BROWN. Yes, sir.

As president and principal party in interest of Marvin K. Brown Cadillac-Oldsmobile, Inc., I wish to present to the Senate Finance Committee a brief résumé relative to my former position and its relation to this above-named corporation.

I have been in the employ of Don Lee, Inc., and its successors for approximately 23 years. These corporations have carried on the business of operating agencies for the sale and service of Cadillac and Oldsmobile automobiles throughout the State of California. among these agencies was the one located at 1302 First Avenue, San Diego, Calif.

For the past 10 years I had been in active management of this particular dealership. On November 1, 1949, I was made president and general manager of Don Lee Motors Corp., which operated, in addition to the San Diego agency, agencies located in Sherman Oaks, Calif., and Burlingame, Calif.

Don Lee Motors Corp. was liquidated August 31, 1950, as a result of the death of Thomas S. Lee, the sole stockholder; and the fact that I obtained the dealership in San Diego did not happen by chance, but rather by a gradual process of working toward some day obtaining this agency.

Throughout the years, both the Cadillac Motorcar Co. and the Oldsmobile division, through their executives, as well as other owners and directors of the Don Lee Co., had indicated that should there be a liquidation of this corporation, I would be in a position to qualify for it. Hence, this new corporation, now Marvin K. Brown Cadillac-Oldsmobile, Inc., is merely a continuance of the Don Lee branch, and is, in a sense, a new corporation in name only.

Thus, commencing with the 1st day of September 1950, I assumed the ownership of the San Diego agency, using the same assets, the same personnel, selling the same products, and generally conducting the same business in the same location, and under the same lease arrangements as its predecessor, Don Lee Motors Corp. There was no interruption of business, and Marvin K. Brown Cadillac-Oldsmobile, Inc., assumed their liabilities—such as new- and used-car warranties, service and repair warranties, time plan finance warranties, accounts receivable, and service contracts with customers.

The continuance of the operation is evidenced by the fact that the State of California recognized the assignment of the employees' insurance reserve so that the new company was allowed to enjoy the unemployment insurance of its predecessors. The city license was transferred on the theory that it was substantially the same organization.

It is reasonable to assume that under the circumstances that the profits realized from the operation of this agency since September 1, 1950, are essentially the same as would have been realized from the operation of this agency, had ownership remained in Don Lee Motors Corp.

The excess-profits-tax law, as it is presently worded, makes it impossible for this company to avail itself of the earning experience of Don Lee Motors Corp., and must instead, use the industry index rate. Thus, based upon the earning experience of the agency during the past years, Don Lee Motors Corp., had it continued to remain in existence, would have had a base of approximately $248,000 before its earnings would be subject to excess profits taxes.

Based upon the industry index rate, Marvin K. Brown, Inc. is entitled to earn, roughly, only $35,000, or approximately one-seventh, before the imposition of excess-profits taxes, notwithstanding the fact that it is engaged in identically the same position at the same location, using the same personnel, and assets, selling the same merchandise in the same manner as its predecessor.

In the area in which I am situated, namely San Diego County, whose population is about 500,000, I am the only dealer out of 32 that is affected by excess-profits taxes, due to the fact that they were operating during these past years—1946 through 1958—and established their base credits. I have been long established in business in San Diego in this particular dealership, as has been previously pointed out, and in addition, I have recently been made president of the San Diego Motor Car Dealers Association, and I mention this to show that I am not a stranger going into a new business but, rather, have been established in this area, and I am continuing on in the very same manner.

In acquiring the assets of this agency, I realized a dream and ambition which I had nourished for many years—to some day own my own business—the dream and ambition of every ambitious and energetic American.

I now find that I am penalized, and I am not permitted to earn as much money from the same business as the former owner would have earned, had he been able to continue to operate his own business.

Senator BYRD. You bought the entire business?

Mr. BROWN. I bought the assets of this business; yes.

Senator KERR. This was another one of the separate branches?

Mr. BROWN. This was one of the stores.

Senator BYRD. You speak of the previous base as being $248,000.

Mr. BROWN. That was the average three best out of four years, 1946 through 1949.

That is exactly the amount that they would have been entitled to earn before they were subject to excess profits.

Senator BYRD. For the part of that you bought?

Mr. BROWN. Pardon me?

Senator BYRD. For the part of the business that you bought?

Mr. BROWN. I bought the assets of the entire business of this agency, but this particular agency would have been allowed to earn $248,000 in a year before they would be subject to excess-profits taxes.

Senator BYRD. And your base is $35,000?

Mr. BROWN. Mine is $35,000, or one-seventh of theirs.

Senator BYRD. It is on a comparative basis?

Mr. BROWN. So, actually, had they been able to operate, they would not have had any excess-profits tax at all, but instead of that, I am in it for most of the year.

Senator KERR. Did the old corporation engage in activities other than the ones in which you are engaged in?

Mr. BROWN. They operated several stores in the State——

Senator KERR. No, I mean——

Mr. BROWN. No; no other activities. Just the automobile sales and service.

Senator KERR. The store where you bought the assets was doing the same business that you are with reference to the kind of business and the scope of the operations?

Mr. BROWN. Yes, Senator Kerr.

Senator KERR. That one branch had been earning, or did earn, an average of $248,000 a year for three of the four best years?

Mr. BROWN. Yes, in that one branch.

Senator KERR. In that one branch.

Mr. BROWN. In other words, that is the base amount that they would be entitled to.

Senator KERR. The package that you bought was the assets of that one branch?

Mr. BROWN. Of that one branch; correct.

In acquiring this agency, a large proportion of which is on borrowed capital, I made certain commitments and although I anticipated that taxes would be increased and that excess-profits taxes would be imposed, I never dreamed that I would not have the same advantages that the former owner would have had, had he continued in business.

Senator MILLIKIN. May I interrupt to ask when you bought the business?

Mr. BROWN. I bought the business on September 1, 1950.

In talking to you gentlemen today, I wish to leave with you the draft of a proposed amendment to the excess-profits-tax law to permit the transfer of an excess-profits-tax credit based upon income by one taxpayer to another in connection with the assets and business of the taxpayer, or a severable portion of such assets and business, and in this particular proposed amendment, only two provisions would require material amendments; and several other provisions will require only the insertion of reference numbers of the amendments being proposed with respect to the two provisions in question.

Hence, if favorable consideration is given this request, the mechanics of incorporating this amendment in the new tax bill should not be difficult and there will be no additional problem in administering the excess-profits-tax laws with respect to the taxpayers who would come within the proposed amendments.

Now, we have, Mr. Dixon, Mr. Hall, and myself, the same amendment that we would like to leave with you gentlemen, and would appreciate favorable consideration.

Senator BYRD. Thank you very much.

Senator TAFT. There again, you have several alternative bases; you have the base of the industry; do you also have a percentage on capital investment?

Mr. BROWN. No, Senator Taft.

I am forced to use the industry index rate.

Senator TAFT. Is that the best thing you can use?

Mr. BROWN. Yes.

Senator TAFT. Have you some alternatives that you can take?

Mr. BROWN. No. As I understand it, the industry rate works out approximately the same.

Senator BYRD. What percentage was the industry rate?

Mr. BROWN. Twenty-five percent was the industry rate worked out for automobile businesses, but as Mr. Hall mentioned, as we understood it at that time they did——

Senator TAFT. Twenty-five percent on what you paid for it?

Mr. BROWN. Now that part of it, I am not clear on. In other words, Mr. Stam can answer that.

Senator TAFT. Is that 25 percent of invested capital?

Mr. STAM. On the total assets.

Senator TAFT. Twenty-five percent on the total assets.

Mr. BROWN. Twenty-five percent on the total assets; yes. And I had exactly the same assets as Don Lee had. In other words, this amounts to a name change only, and I am asking for relief in that their base would have been seven times higher than mine, and I have exactly the same responsibilities, handling the same products, and so forth, as they. I am sure it was not the intent of Congress to impose an excess-profits-tax law for this type of business, where you are operating the same business exactly, rather than one starting from scratch, with a small amount of tools.

It has always been my impression that a person——

Senator TAFT. I think it was the intent of Congress, but I do not say it was the right intent. But I think we had up distinctly the question to consider whether we would allow the base of purchased assets.

So it is the fault of Congress that we must correct. I do not think you can blame the Department on that.

Mr. BROWN. We certainly appreciate that, Senator.

Senator MILLIKIN. When you made the purchase, you did not have fair notice of what might happen to you?

Mr. BROWN. No, sir.

Senator MILLIKIN. Let me remind you in that connection, that we had the first rumble of excess-profits tax on the floor of the Senate in August of last year.

Mr. BROWN. Right.

Senator MILLIKIN. But that which was proposed was so unacceptable that we decided to take more time and do the job later on. So, perhaps you could contend that even knowing about the August attempt to set up an excess-profits tax, you were entitled to consider that that was a false start, and that which followed would be different?

Mr. BROWN. Yes, sir.

If I may say just one thing: At the time I started in business, certainly we knew that this was up for consideration. At that time, if you will recall, in September of 1950, I think it was 42 or 47 percent, the surtax, the corporate tax, and then when we completed December, and on January 2, when this was passed, we were retroactive to July 1. So, in going back to July 1 as we closed the statements, that had a great effect on us, because what I entered in the business, I had the idea of around 43 or 47 percent as the corporate tax.

In addition to that, of course, we had the excess-profits tax, and my point is, really establishing a base where I could not be subject to it as soon. Truthfully, the former company would not have been subject to excess-profits tax at all this year, where I will be there probably three-quarters of the year.

Senator TAFT. Perhaps you can explain something that strikes me as curious in the underlying facts of these situations.

Why is it that a business earning $250,000 a year is sold for $250,000 in cash?

I mean, what is it in the automobile business that is so different from any other business?

In all these three cases, in effect, so far as I can make out, you people who acquired it, paid no more as a capital sum than the average earnings for 3 years from 1946 through 1949.

I am talking about newspapers. You buy these things on 6 times earnings or 10 times earnings. Why is an automobile agency of that sort any different?

Senator KERR. The owner does not have a fixed title to the franchise. He cannot transfer it. The Cadillac Motor Co. is the only one who can do it.

Senator TAFT. But what is the basis?

Mr. BROWN. I think I can answer that.

First of all, if you recall, the great years in the automobile business, the only years they have made any money, were 1946 through 1949, and you have the 4 best years probably to go on as a base credit for them. Previously, they struggled——

Senator TAFT. You mean, after the war, with the flood of new orders?

Mr. BROWN. Yes, sir. They were the big years, and all the automobile dealers had, of course, a good operating net profit. Then, of course, in the Cadillac franchises, or Oldsmobile, or any of the automobile franchises, there is no bonus for good will paid for them. They are simply handed over to the operator wherever he can qualify. So you are not buying the business——

Senator BYRD. On the certainty that you will get the thing?

Mr. BROWN. No. And when you buy one, you simply buy the assets of the business, whatever the inventory is.

Senator TAFT. And when you buy a radio station, you are not sure that you are going to keep that franchise, either?

Mr. BROWN. That is right.

Senator KERR. If the fellow does not die, he has no guaranty of being able to continue as the owner of a local automobile franchise?

Mr. BROWN. If he dies, he automatically loses the franchise.

Senator KERR. But, I say, if he does not die, he keeps it, subject to the will of the manufacturer?

Mr. BROWN. Right.

Senator KERR. So that he does not have any fixed asset like the owner of a newspaper, or something else?

Mr. BROWN. Right. He operates on a year-to-year basis, year-to-year franchise.

Senator BYRD. Thank you very much, Mr. Brown.

Mr. BROWN. Thank you, gentlemen, very much, indeed.

Senator MILLIKIN. Mr. Chairman, Senator Nixon is here. I wonder whether he wanted to say anything about the matter.

We have already indicated for the record that you are interested in this matter.

Senator NIXON. Just for the record, that indicates my interest. They gave the facts of the case to me, and I wanted to be here to hear their presentation before the committee.

Senator BYRD. Thank you, Senator.

Senator BYRD. Mr. George Lycn.

Will you identify yourself for the record, please, sir.

STATEMENT OF GEORGE W. LYON, JR., STAFF MEMBER, BANSLEY & KIENER, CERTIFIED PUBLIC ACCOUNTANTS, CHICAGO, ILL.

Mr. LYON. Mr. Chairman, and members of the committee, my name is George Lyon, Jr., a staff member of Bansley & Kiener, certified public accountants, of Chicago, Ill.

I am not here pleading for an expansion of the relief provisions of the present act, although at first glance our problem is somewhat akin to the problem of the three individuals who testified here this morning.

All I seek is the right to compute the normal base period earnings on the basis of actual earnings of a going business in the base period.

And I believe it can be done without changing the relief provisions of the excess profits tax in any degree whatsoever.

Senator KERR. All you seek is that they be made applicable to the new corporation that succeeds to the assets of the old one?

Mr. LYON. That is correct, but not through relief provisions of the excess profits tax law.

Senator KERR. So what you are seeking here is a provision which would cover such a situation?

Mr. LYON. Our situation is pretty clean-cut, since we took over everything that the other business had, the same location of the entire previous corporate entity, and all of the assets.

We did not take over a part in the break-up of a previously existing entity.

It seems perfectly clear from a reading of the present act that the earning histories of the retiring and continuing corporations were to be considered as one in computing an excess profits credit.

However, this right has been extended only to an acquiring corporation acquiring the business of the retiring corporation in a nontaxable reorganization.

I seek only the right to use the combined earning histories of the two corporations in situations where there is no duplication of earnings even though the succession is not the result of a nontaxable acquisition.

The situation in this case to which I refer can best be illustrated by a recitation of the facts in a case which clearly demonstrates a compelling distortion of normal earnings under the present act.

I refer to the case of West Side Buick, Inc., an automobile distributor in the Chicago area.

The principal stockholder of the predecessor corporation held the franchise from General Motors Corp. for the sale of Buick automobiles in a certain prescribed area in Chicago. This franchise was non-assignable and nontransferable hence had no value as a corporate asset.

When the holder of the franchise died in November 1947 General Motors issued a similar franchise late in the same month to Mr. Williams. Mr. Williams thereupon caused a corporation to be formed for the express purpose of acquiring th' business, trade name, location, and assets of the predecessor corporation which, by reason of the loss of the franchise was destined for liquidation, because of the death of the franchise holder.

The physical assets were purchased with new capital, the lease on the building was assumed and the business continued at the same address with the same employees and the same customers.

Senator MILLIKIN. But it was not the same corporation?

Mr. LYON. No, it was not.

The acquisition of the business in a nontaxable transaction was not feasible since the continuation of the business without interruption was essential to a practical transition of ownership of the business.

At that point, I might say that in view of the death of the principal shareholder, it would have required probate court approval to have effectively transferred this stock in order to work out a nontaxable reorganization, which was not expedient at the time.

This taxpayer, the present taxpayer, was in operation only 25 months in the base period. Had it acquired the business of its predecessor in a nontaxable transaction it would be able under the present act to use the base-period earnings of its predecessor in order to make up a full base period.

Let us look at this problem percentagewise with respect to the distortion between corporation A and corporation B, corporation A being the corporation that resorted to a nontaxable transaction, and corporation B being the corporation that was compelled to resort to a taxable acquisition. Both acquiring corporations were in business for a period of 25 months in the base period, and both of the predecessor corporations had been in business for more than 23 months prior to the date of acquisition by the continuing corporations, to make a full 48-month base period.

Senator MILLIKIN. This may not have any bearing on your problem, but how do you value a franchise of that kind when you get it?

Mr. LYON. The franchise has no value when it is gone.

Senator MILLIKIN. I understand that you get a new one. But how do you value that when you get it?

Mr. LYON. It has no value.

Senator MILLIKIN. Is it not set up on the books as of any value?

Mr. LYON. It is a personal contract between General Motors Corp. and the individual in the business.

Senator MILLIKIN. I understand the nature of it. I am just asking you, how do you set it up on the books?

Mr. LYON. It is not set up on the books.

Senator MILLIKIN. It is not set up on the books?

Mr. LYON. No, sir. It is something that is personal to the individual who is operating the business.

Under the present act corporation A is allowed to use the best three out of four of the combined base-period earnings, whereas corporation B is limited to twenty five thirty-sixths or only 69 percent of its actual earnings for the 25-month period, which is supposed to be normal earnings.

In computing the excess profits credit, corporation A is entitled to 85 percent of the combined earnings in 36 months of the base period, whereas corporation B is limited to 85 percent of 69 percent of its earnings in only 25 months of the base period.

When a new corporation is formed in the base period the earnings potential is an unknown quantity and for this reason it received separate treatment under the act, with right of election between averaging its own base-period earnings and resorting to a hypothetical earnings history to be determined on the basis of an industry percentage return on assets.

Obviously a new corporation having for its purpose the continuation of a going business was not to be treated as a new corporation as defined in the act. It is perfectly apparent that the intent was to accord all such continuing businesses the same treatment, and this because of the known normal earnings of the business as a going concern, irrespective of who the new owner is going to be.

Under the prior act all successor-continuing corporations that had acquired all or substantially all of the assets of its predecessor were entitled to use the earnings of such predecessor in the reconstruction of its base period net income, provided only there was no duplication of earnings.

Under the present act such use is allowed to most corporations and denied to others merely because of a deficiency in the statutory language. West Side Buick happens to fall in that group of corporations to which such use is denied, notwithstanding the fact that the circumstances under which it became a successor-continuing corporation are the same in all respects except only the method of acquisition and succession.

The facts and circumstances incident to such acquisition and succession are clearly within the broad band of intendment of the present act, but not within the letter.

In conclusion, I respectfully submit that it was not the legislative intent to discriminate against successor-continuing corporations solely on the ground of method of acquisition and succession.

With the permission of this committee, I should like to file as part of the record here, a more complete statement of the contentions which I so briefly touched upon here.

Senator BYRD. That will go in the record.

Senator MILLIKIN. I would like to ask you about the successor corporation. Let me ask the question that Senator Kerr asked a while ago. Does it carry on precisely the same operations as the preceding corporation?

Mr. LYON. Exactly the same.

Senator MILLIKIN. Do they have the same quarters?

Mr. LYON. The same quarters.

Senator MILLIKIN. Do they have the same facilities?

Mr. LYON. The same facilities.

Senator MILLIKIN. And generally the same customers?

Mr. LYON. The same customers.

Senator MILLIKIN. As far as you can determine?

Mr. LYON. Yes, sir. Some new ones come along.

Senator MILLIKIN. Did you assume the debts of the preceding organization?

Mr. LYON. As far as ordinary trade payables and receivables, those were not purchased, because the predecessor wanted to take care of those.

Senator MILLIKIN. And that I assume was reflected in the purchase price of the new business?

Mr. LYON. Assuming that there was no discount because of the death involved, I imagine it was just a cash transaction.

Senator MILLIKIN. It is perfectly obvious that had you been required to assume debts, you would have paid less for the business?

Mr. LYON. But we did not acquire the predecessor's receivables, either.

Senator MILLIKIN. I understand that, but what I want to point out is that had you acquired the debts, you would have paid less for the business?

Mr. LYON. That is right.

Senator TAFT. Mr. Lyon, let me ask you one question. Have you filed excess-profits-tax returns for 1950 under this law?

Mr. LYON. Under this law? Yes, for this particular taxpayer we have.

Senator TAFT. For this particular one. But in your business as an accountant, have you filed them for other persons?

Mr. LYON. We have prepared quite a number of excess-profits-tax returns for 1950.

Senator TAFT. For year ending December 31, 1950?

Mr. LYON. For December 31, 1950; right. We have some returns which we have been unable to prepare because of the absence of part II regulations.

Senator TAFT. I am wondering if there has been any difficulty in filing 1950 returns.

Mr. LYON. I might say this, Senator: We are still working on tax returns in our office that should have been filed on March 15.

Senator TAFT. I wondered how much information would be available to us.

Mr. LYON. The difficulty we find in our office is that, in order to build up the base periods and get all the necessary information, so much time is consumed in dusting off the old records and digging them out again. We put them away once, thinking the excess-profits tax was something akin to World War II and we would not have it again for some time. We were sort of taken by surprise again. Had we known, we would have kept a continuity in the record which would have simplified that.

Senator TAFT. You have gotten a lot of extensions in which to file; have you?

Mr. LYON. That is true. The collectors were very liberal.

Senator TAFT. Mr. Stam, how much information is available on the 1950 returns of excess-profits taxes? Has the Treasury been able to compute anything yet?

Mr. STAM. No; not yet. And that was one of the reasons why they suggested in the House that they might not be in a position to give the committee any information on any of the problems at this time, because the returns had not been filed, and they had not had a chance to study them. They filed tentative returns, but they got an extension to file the complete return.

Senator BYRD. What date was the excess-profits tax effective?

Mr. STAM. It was effective the beginning of this fiscal year. But they filed the tentative returns in March.

Senator BYRD. This is a fiscal-year company, I suppose.

Mr. LYON. That is not true—a calendar year.

Senator TAFT. But it covered the last 6 months of 1950.

Mr. LYON. Those returns would have been on March 15. Now, in addition to that, we have filed returns before the excess-profits tax law was passed, and we were required to go back and process those returns and file them over again. That, too, added to our delay in being able to comply with the filing requirements.

Senator MILLIKIN. When did your clients buy this business?

Mr. LYON. December 1 of 1947. They had 25 months in the base period up to December 31 of 1949.

Senator BYRD. Thank you very much.

Mr. LYON. Thank you.

(The paper submitted by Mr. Lyon follows:)

STATEMENT OF GEORGE W. LYON, JR.

My name is George W. Lyon, Jr., a staff member of Bansley & Kiener, certified public accountants, of Chicago, Ill.

My purpose in appearing before this committee is to point out the necessity of an amendment of the language of the present Excess Profits Tax Act to eliminate a discrimination between certain corporate groups in the reconstruction of its base-period net income.

I am not here pleading for an expansion of the relief provisions of the present act, but merely for the right to determine the base-period net earnings of a successor-continuing corporation on the basis of an actual earning history.

This right is now allowed to practically all successor-continuing corporations; but, unfortunately—and, I believe, inadvertently—denied to a certain small group of corporations merely because of a deficiency in the statutory language of the act.

My point can best be made by resort to a general discussion of the provision of the past and present acts and their application to the facts and circumstances incident to the acquisition and succession of one particular taxpayer which is, under the language of the present act, denied the right to use combined earnings of itself and its predecessor in computing the base-period net income in arriving at its excess-profits tax credit for any of the excess-profits tax years.

The name of this taxpayer is West Side Buick, Inc. The business of the predecessor was and of this taxpayer is that of an automobile agency under the terms of separate franchises obtained from General Motors Corp. of Detroit. The address of both corporations was and is northeast corner of Washington and Kilpatrick Avenue, Chicago, Ill. The predecessor corporation had been in business at this location for a period of more than 25 years prior to November 1947, and had built up an enviable reputation in the sale and servicing of Buick automobiles.

The business, the location, the employees, and the customers of this business are all of long standing in the community, and the only thing new about the business is the corporate entity under which it is operated. The present corporation was incorporated in the State of Illinois on December 1, 1947. Almost simultaneously, the corporation purchased substantially all of the physical assets of the predecessor corporation, whose president and principal shareholder had passed away in the month of November of 1947. At that time all of the employees of the predecessor corporation came over to the present corporation. In addition, the obligations of the predecessor corporation to those employees were assumed by the present corporation. The list of customers, service accounts, and other business contacts were likewise taken over by the present corporation. The only principal asset which was not purchased by the present corporation was the nontransferable, nonassignable dealer franchise from the General Motors Corp.

The Excess Profits Tax Act of 1950 fails to make any distinction between "new corporations" and "new businesses." When a new business is formed the earnings potential of that business is unknown, and provision is made in the excess-profits-tax law for the use of a hypothetical base-period earnings history to be determined on the basis of an industry percentage return on assets. This hypothetical earnings history is substituted for the unknown normal earnings potential of the new business. A "new business" is not synonymous with a "new corporation," however, and a distinction must be made between a new business and a new corporate entity which takes over an old-established business. In the case of the old-established business, the earnings history is known, and normal earnings for that business can be determined with reasonable certainty. Since the earnings potential is known, we have no unknown quantity to provide for as we do in the case of a new business. The actual earnings history of the business, irrespective of its owner, is the best criteria of normal earnings and much closer to reality than any hypothetical construction of normal earnings based upon industry-wide averages.

In the computation of the excess-profits credit under the income method, the present corporation is limited to the general average method, which is available to all corporations, or the relief provision for new corporations. The relief provision for new corporations, which permits an industry rate of return on assets to be substituted for the unknown average normal net income, does not yield an adequate credit representative of normal earnings. The largest credit this corporation presently has is computed under the general average method of determining normal earnings in spite of a distortion of actual normal earnings caused by the statutory formula.

The general average method of computing an excess-profits credit utilizes a minimum of 36 months determining an average base-period net income, which forms the basis of the credit. If the corporation has not been in existence for 36 months in the base period, the missing months are figured at zero in determing the average for the 36 months. The reason for this is found in the last sentence of section 435 (d) (1), which provides as follows: "The excess-profits net income for any month during no part of which the taxpayer was in existence shall be zero."

Generally, corporations are allowed to use the best 3-out-of-4 years in the base period as their average earnings for purposes of the excess-profits credit. It was obviously intended that any corporation's average base-period net income should be 100 percent or more of the corporation's average actual earnings in the base period. With the minimum requirement of 36 months and the substitution of zero for any month in which the corporation was not in existence, this corporation's actual earnings are arbitrarily unreasonably discounted in the process of determining the statutory average. The statutory formula under the general average method as applied to this corporation results in only 69 percent—25 months divided by 36 months—of its actual earnings in the base period being considered as the corporation's average base period net income.

While other taxpayers enjoy an excess-profits credit of 85 percent, more or less, of actual base-period earnings, this corporation's credit is limited to 59 percent—85 percent of 69 percent—of the corporation's actual base-period net income. A discount of approximately 15 percent of base-period earnings was extended in the 1950 act, but I do not believe it was ever intended that a corporation's actual base-period earnings should be discounted 41 percent in order to determine its excess-profits credit.

Measures of relief such as growth, increased capacity, or change in products or services are not available to this corporation since it was not in existence on the first day of its base-period; namely, January 1, 1946. The only alternative method of computing an excess-profits credit for this taxpayer is that accorded a "new corporation," under the provisions of section 445 of the present act, which permits the reconstruction of average base-period net income by way of an industry rate of return of assets.

Provision was made in the 1950 act for combining the earning histories of predecessor and successor corporations when nontaxable reorganizations are involved. These provisions are substantially similar to those contained in the World War II law. All the bases for relief under section 722 in the world War II law were carried over to the present law, but the method of reconstructing normal earnings for a corporation is now tied in with the corporation's industry under the present law rather than the tailor-made reconstruction which was based upon the particular corporation's actual earnings experience. Under section 722 of the prior act, the foundation or basis for a reconstruction was the actual experience of the successor corporation combined with the experience of its predecessor, irrespective of whether a taxable or a non-taxable reorganization was involved, provided only that there was no duplication of earnings. The starting point or foundation upon which any reconstruction was built was the actual experience of the combined entities for purpose of rounding out a full base period.

New corporate entities which are the successors to old-established businesses should have the right to have normal earnings determined by a combination of the experience of the present and predecessor entities, whether or not the present entities are the result of a taxable or a nontaxable acquisition of the old-established business, subject only to the nonduplication of earnings test. There is little practical difference between the acquisition of assets in a taxable as compared with a nontaxable reorganization. In either case it is, nevertheless, the same business, the same assets, and the same earnings potential which is acquired. The disparity and treatment in the Excess Profits Tax Act of 1950, however, between a taxable and a nontaxable acquisition of a business results in rank discrimination. This is not a situation in which there is involved any duplication of credit from the same earnings experience. This is purely and simply a case of one corporation buying a business and the predecessor corporation immediately liquidating and dissolving.

There is attached hereto a supplement which contains a proposal which would correct the distortion of normal earnings by permitting successor corporations resulting from taxable reorganization to combine their experience with that of their predecessors to round out a full base period from which to determine normal average base-period net earnings. The proposal would amend only the language of section 435 (d) (1) by inserting at the end of the second sentence thereof authority for combining the earnings of predecessor and successor corporations in situations where substantially all of the assets of a corporation are acquired in a transaction which does not constitute the taxpayer an acquiring corporation within the provisions of section 461. No expansion of the relief provisions under the excess-profits tax law is contemplated and none will be required. All that is necessary is a correction of a distortion of normal earnings which form the basis of an excess-profits credit in a situation involving a taxable reorganization during the base period.

The facts and circumstances incident to the acquisition of the business of this taxpayer's predecessor seem to bring this succession and continuation transaction clearly within the ambit of the broad intendment, but not quite within the letter, of the present act.

In conclusion, I respectfully submit that it was not the legislative intent to discriminate against successor-continuing corporations solely on the ground of the particular method of acquiring and succeeding to the business of the predecessor corporation.

Supplement to the Statement of George W. Lyon, Jr.

PROPOSED AMENDMENT TO THE EXCESS PROFITS TAX ACT OF 1950

SEC. 435. EXCESS-PROFITS CREDIT—BASED ON INCOME.—

* * * * * * *

"(d) AVERAGE BASE-PERIOD NET INCOME—GENERAL AVERAGE.—The average base-period net income determined under this subsection shall be determined as follows:

"(1) By computing the excess-profits net income for each month in the base period. The excess-profits net income for any month during any part of which the taxpayer was in existence shall be the excess-profits net income for the taxable year in which such month falls divided by the number of full calendar months in such year, but in no case shall the excess-profits net income for any month be less than zero. The excess-profits net income for any month during no part of which the taxpayer was in existence shall be zero."

Proposed amendment to section 435 (d) (1) by inserting at the end of the second sentence thereof the following:

"If the taxpayer commenced business during the base period as a result of the acquisition of substantially all of the assets of another corporation in a transaction which does not constitute the taxpayer an acquiring corporation within the provisions of section 461 and after the transaction such other corporation ceases business, in the alternative, the excess-profits net income for any month during the base period prior to the month in which the taxpayer commenced business may be the excess-profits net income of such other corporation for the taxable year in which such month falls divided by the number of full calendar months in such year preceding the month in which the taxpayer commenced business, but in no case shall the excess-profits net income for any month be less than zero."

The last sentence of section 435 (d) (1) should be amended by inserting as a prefix thereof, the following: "Except as hereinabove provided * * * ."

WEST SIDE BUICK, INC.

[The italicized portion indicates the insertion of the proposed amendment. There are no deletions involved]

Text of section 435 (d) (1) of Excess Profits Tax Act of 1950 after reflecting the proposed amendment:

"(d) AVERAGE BASE-PERIOD NET INCOME—GENERAL AVERAGE.—The average base-period net income determined under this subsection shall be determined as follows:

"(1) By computing the excess-profits net income for each month in the base period. The excess-profits net income for any month during any part of which the taxpayer was in existence shall be the excess-profits net income for the taxable year in which such month falls divided by the number of full calendar months in such year, but in no case shall the excess-profits net income for any month be less than zero. *If the taxpayer commenced business during the base period as a result of the acquisition of substantially all of the assets of another corporation in a transaction which does not constitute the taxpayer an acquiring corporation within the provisions of section 461 and after the transaction such other corporation ceases business, in the alternative, the excess-profits net income for any month during the base period prior to the month in which the taxpayer commenced business may be the excess-profits net income of such other corporation for the taxable year in which such month falls divided by the number of full calendar months in such year preceding the month in which the taxpayer commenced business, but in no case shall the excess-profits net income for any month be less than zero. Except as hereinabove provided,* the excess-profits net income for any month during no part of which the taxpayer was in existence shall be zero."

NOTES ON PROPOSED AMENDMENT TO SECTION 435 (D) (1) OF THE EXCESS PROFITS TAX ACT OF 1950

1. The amendment inserting the third sentence in section 435 (d) (1) is fashioned after the last sentence of section 35.722 (b) (4) of regulation 112.

2. It is necessary to insert the amendment as the third sentence of section 435 (d) (1) in order to preserve the position in the subsection of the present last sentence, since it is referred to as the "last sentence" in other sections of the act. For example, see section 462 (b) (2).

3. Second sentence of section 435 (d) (1) must be left intact as it is likewise referred to in other sections. For example, see section 435 (e) (2) (E).

Senator BYRD. The committee is recessed until 10 o'clock tomorrow morning.

(Thereupon, at 12 noon, the committee adjourned until 10 a. m. Thursday, July 26, 1951.)

REVENUE ACT OF 1951

THURSDAY, JULY 26, 1951

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

The committee met, pursuant to recess, at 10 a. m. in room 312, Senate Office Building, Senator Clyde R. Hoey presiding.

Present: Senators Hoey, Connally, Byrd, Kerr, Millikin, Taft, Martin, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator HOEY. The committee will please come to order.

We have a large number of witnesses, and 10 minutes have been allotted to each witness, and the committee sincerely hopes that the witnesses will be able to stay within that limit.

Of course, in each instance the full statement can be put in the record. However, if they can confine their oral testimony to 10 minutes, it would be most agreeable to the committee.

Senator Connally has to leave in a few moments, and I am going to call out of order Mr. Eugene German to testify first.

Mr. German, will you come up, please.

Senator CONNALLY. Mr. Chairman, at the close of Mr. German's testimony, I ask unanimous consent to insert this memorandum in the record.

Senator HOEY. It will be done. Have a seat, Mr. German, please. Give your name and connection to the reporter, please.

STATEMENT OF EUGENE GERMAN, VICE PRESIDENT AND TREASURER, DUVAL SULPHUR & POTASH CO., HOUSTON, TEX.

Mr. GERMAN. My name is Eugene German. I am vice president and treasurer of Duval Sulphur & Potash Co., of Houston, Tex.

The Duval Sulphur & Potash Co. is engaged in the production and sale of crude sulfur from its sulfur mine at Orchard in Fort Bend County, Tex. The company is also engaged at present in developing a new potash mine near Carlsbad in Eddy County, N. Mex.

We are concerned about certain inequities in the Excess Profits Tax Act of 1950, particularly as applied to sulfur and potash.

Section 453 of the Internal Revenue Code provides generally for the exemption from excess-profits taxation of the income from excess output of certain minerals, as well as other natural resources.

Subparagraph (b) (1) of such section sets forth a general rule to the effect that the exemption is a portion of the excess output—which is defined as the output in the taxable year over the annual output during the years 1945–1949—but the amount of the exemption is dependent upon the percentage that the excess output exceeds certain percentages of the estimated recoverable reserve of this particular mineral then held by the owner of the property.

Subparagraph (b) (2) of section 453 sets forth an alternative rule with respect to a metal- or coal-mining property which provides for an exemption from excess-profits tax of the income from the excess output in the taxable year multiplied by one-half of the unit net income from such property for such year; this applies regardless of the then estimated recoverable reserve.

Also subparagraph (b) (4) of section 453 exempts one-third of the output of new mines extracting metals or coal. This exemption was also given to timber and natural-gas properties. There is no similar provision for the nonmetallic minerals.

The World War II excess-profits tax law contained in section 735 a partial exemption for coal and iron mines and timber properties not in operation during the base period; this was retained in the House version of the 1950 statute.

However, in the Senate this partial exemption was broadened to include all metallic mines and natural-gas properties, as stated in the committee report, "in order to provide a greater incentive for the opening up of new properties" and "in order to place them in a similar tax position with competitive properties in operation during the base period."

It is difficult to see why the present law should be restricted to coal and metal mines. What reason is there that the same incentive is not extended to new mines for such urgently needed nonmetallic minerals as sulfur and potash? How can such discrimination be justified? Why should metal and coal mines alone have the alternative computation of section 453 (b) (2)? Why should not a new sulfur or potash mine be placed in a "similar tax position with competitive properties in operation during the base period"?

The nonmetallic mines are now in a worse position than they were under the World War II law, for under the old law there was some possibility of relief under sections 721 and 722. Under the present law the failure to grant relief to nonmetallic mines in subparagraph (b) (4) of section 453 results in taxing the normal profit of new nonmetallic mines, a distinctly discriminatory treatment not only between industries but also against new mines in the same industry.

For such urgently needed minerals as sulfur and potash it would seem fair and equitable, as well as in the national interest, to provide the producers of sulfur and potash with "this greater incentive for the opening up of new properties" and in order to place them in a "similar tax position with competitive properties in operation during the base period."

Senator MILLIKIN. There is a serious shortage of sulfur, is there not?

Mr. GERMAN. That is right.

Therefore, section 453 should be amended by broadening subparagraphs (b) (2) and (b) (4) thereof to include all nonmetallic mines and thereby give them the same benefits as are now given to coal and metal mines.

Senator CONNALLY. Right there, is there any reason why that should not be done?

Mr. GERMAN. I know of none.

Senator CONNALLY. Otherwise there would be a discrimination against them.

Mr. GERMAN. Very plainly so, I think.

Senator CONNALLY. Go ahead.

Senator HOEY. Go ahead.

Mr. GERMAN. This could be accomplished by striking out the phrase "coal and metal mining" or "metal mining" in all places that said phrases appear in said subsections and inserting in lieu thereof the phrase "mineral property."

To illustrate the pressing need of the proposed amendment, Duval Sulphur & Potash Co. is now engaged in opening up a new potash mine near Carlsbad, N. Mex., to supply a part of the ever-increasing demand of the United States for this essential fertilizer material, and is also looking for new commercial deposits of sulfur.

The Southwest Potash Corp. is also engaged at present in developing a new potash mine in Eddy County, N. Mex., and the potash companies already producing in the New Mexico area have all expanded their mining facilities in recent years in an attempt to make the United States self-sufficient as regards potash.

The Texas Gulf Sulphur Co. has recently placed in operation a new sulfur mine at Moss Bluff dome in Liberty County, Tex., and is in process of opening another sulfur mine at Spindle Top dome near Beaumont, Tex.

Jefferson Lake Sulphur Co. has just started production of sulfur from a new mine at Starks dome in Louisiana.

Freeport Sulphur Co. is now in process of opening a new sulfur mine in south Louisiana at a location known as Bay St. Elaine dome.

It is not believed that the proposed amendment means any substantial loss of revenue to the Government. On the contrary, if the restrictions imposed by the present section 453 are removed, there will be not only the incentive to increase excess output of nonmetallic mines but also to explore and put into operation new mines. Quite probably this might occur to the extent that actually additional revenue would be received due to the enactment of the suggested amendment.

I am sure that you gentlemen will agree that the development of new deposits of potash and sulfur is essential to the continued welfare of this country. There are other nonmetallics which are also vitally needed in this country and for that reason as well as for the other reasons explained above we respectfully urge that section 453 (b) (2) and (b) (4) be amended to apply to all mineral properties.

Thank you.

Senator HOEY. Thank you, Mr. German.

Senator CONNALLY. Mr. Chairman, let me interrupt for a moment. I have to go pretty soon.

Senator HOEY. Senator Connally.

Senator CONNALLY. Our State and Louisiana produce more sulfur than probably all of the rest of the country combined, and we know how important that is to the general welfare of the United States and especially for defense purposes; is that not true?

Mr. GERMAN. That is right.

Senator CONNALLY. I say, is it not a fact that sulfur is essential in the defense preparedness effort?

Mr. GERMAN. Yes, sir; in very many industries.

Senator CONNALLY. So I hope the committee will give careful attention to the proposition that Mr. German has presented. I am very much interested in it because my State is so vitally concerned.

At this time I would like to ask that this be placed in the record.

Senator HOEY. That will be done.

(The memorandum dated July 26, 1951, is as follows:)

MEMORANDUM

JULY 26, 1951.

To the Chairman and Members of the Finance Committee of the Senate of the United States

GENTLEMEN: The following memorandum is submitted on behalf of Texas Gulf Sulfur Co., a producer of sulfur by the Frasch (or hot water) process in the State of Texas, and by recovery from sour natural gas in the State of Wyoming.

The subject of this memorandum is the proposal that section 453 of the Excess Profits Tax Act of 1950 be amended by including nonmetallic minerals within the provisions of subsections (b) (2) and (b) (4) thereof.

At the time the Excess Profits Tax Act of 1950 was under consideration by the Congress, it was generally felt desirable that the general relief provision, section 722,[1] be replaced by provisions containing more rigid tests. As stated in the House report:[2]

"(c) *General relief provisions of the bill.*—The bill provides automatic formulas for each of the most important types of cases which arose under the old section 722. The use of such formulas permit an objective computation of the exact amount of relief to be granted in each case, rather than leaving the extent of relief dependent upon an attempted analysis of all the varying factors of each case, with uncertainty and disparity among taxpayers the inevitable result. It is believed that the proposed approach to the determination of relief problems will avoid in large measure the difficulties of proof and the subjective determinations which characterized the administration of section 722 and will eliminate the delays which attended the provision of relief for hardship cases under the World War II law."

Under the World War II act a mining company which brought into production a new property in order to supply the increased demand for minerals, thus impairing its ore reserves, was entitled to relief from excess profits taxation under the provisions of section 721[3] or section 722. This type of relief is no longer available.

Another provision of the World War II law which was designed by the Congress to prevent injustices arising out of the depletion of new mines and the taxation of all the income therefrom at excess profits rates, was subsection (2) (4) of section 735. This subsection allowed the exclusion from excess profits tax of one-sixth of the[4] net income from coal, iron, and timber properties not in operation during the base period.

While nonmetallics (other than coal) were not included in this provision, this omission was of no great concern to them because of the relief afforded by sections 721 and 722, which although somewhat cumbersome to obtain, was clearly available. But the Congress, in enacting the Excess Profits Tax Act of 1950 eliminated the general relief provisions, and while broadening subsection (b) (4) of section 735 (sec. 453 of the 1950 act) by the inclusion of all metal mines, has left producers of nonmetallics (other than coal) with no protection against the rapid depletion of new mines and the taxation of the proceeds at the extremely high excess profits rates.

In connection with subsection (b) (4) this committee stated last year:[5]

"The World War II statute also contained a provision providing partial exemption for coal and iron mines and timber properties not in operation during the base period. One-sixth of the net income in the current taxable year of these properties was exempt from excess profits tax. The House bill continued this provision without change. Your committee's bill makes several changes in this

[1] Sec. 722 was the general relief provision relating to cases where the taxpayer could show that the tax would be "excessive or discriminatory" in absence of relief under that section.

[2] 1950, 2 I. R. B. 29, 40.

[3] Sec. 721 (a) (2) (C) applied to income resulting from exploration, discovery, etc. Regulations 112, sec. 35.721-7 gives as an example "income arising out of a unit of property such as an oil lease or other mineral property * * *."

[4] The Senate provided for the exclusion of one-half such net income, the House one-sixth, and in conference the Senate receded.

[5] 1950, 3 I. R. B 15, 37.

provision. The exemption from excess profits tax for properties coming under the provision is increased from one-sixth to one-third of the net income from such property *in order to provide a greater incentive for the opening up of new properties.*" [Emphasis supplied.]

The very desirable incentive for opening new mines (or more properly the partial removal of a very serious penalty against opening new mines) applies to nonmetallics with equal or greater force than to metals. There is no more vital mineral in the defense economy than sulfur, nor one whose current short supply creates a more critical problem in the defense of the free world. In this connection attention is called to hearings held February 20–23, 1951, before the Subcommittee on Fertilizer and Farm Machinery of the House Agriculture Committee and before the Subcommittee on Newsprint of the House Interstate and Foreign Commerce Committee on May 23, 1951, which deal with the seriousness of the world shortage of sulfur.

Subsection (b) (4) should, therefore, be amended by including nonmetallic minerals within the terms thereof.

Another serious inequality in section 453 is found in subsection (b) (2). Section 453, subsection (a) permits the exclusion of certain percentages of the excess output of mines (including sulfur and other nonmetallics). Because under this provision relief may not be had unless the output is highly excessive, and then only to a very limited extent, this provision is of little practical use in a great many cases. In recognition of this restricted application of subsection (a), subsection (b) (2) provides an alternative in the case of coal and metal mines; that is, the taxpayer at his option may choose to exclude from excess profits taxation one-half of the net income from excess output.

The same arguments apply for the extension of this subsection (b) (2) to nonmetallics as do those for the extension of (b) (4). There is no reason for this discrimination against nonmetallics, and it being desirable to stimulate the production of nonmetallic minerals, including sulfur, to the same extent as metals and coal, the inclusion of nonmetallic minerals under subsection (b) (2) of section 453 would remove to a considerable extent this present discrimination and consequent tax discouragement to their production.

In summary, we urge the inclusion of nonmetallic minerals within the provisions of subsections (b) (2) and (b) (4) of section 453 of the Excess Profits Tax Act of 1950, and suggest the following changes in these subsections to accomplish this purpose (deletions indicated by brackets, additions by italics):

"(2) MINES IN OPERATION DURING NORMAL PERIOD.—For any taxable year, the nontaxable income from exempt excess output of a [metal or coal mining] *mineral* property which was in operation during the normal period shall be an amount equal to the excess output of such property for such year multiplied by one-half of the unit net income from such property for such year, or an amount determined under paragraph (1), whichever the taxpayer elects in accordance with regulations prescribed by the Secretary.

* * * * * * *

"(4) MINES, TIMBER PROPERTIES, AND NATURAL GAS PROPERTIES NOT IN OPERATION DURING NORMAL PERIOD.—For any taxable year, the nontaxable income from exempt excess output of a [metal or coal mining] *mineral* property or a timber block or natural gas property, which was not in operation during the normal period, shall be an amount equal to one third of the net income for such taxable year (computed with the allowance for depletion) from the [metal or coal mining] *mineral* property, the timber block, or the natural gas property, as the case may be. For the purposes of the preceding sentence, a [metal mining] *mineral* property shall be deemed not to have been in operation during the normal period if, during the period it was in production during 1946, 1947, 1948, and 1949, the aggregate gross income derived therefrom was less than the aggregate of the deductions (allowed under sec. 23 without regard to any net operating loss deduction) attributable to such property during such period of production."

Senator HOEY. Mr. Paul V. McNutt. Be seated and give your name and connection to the reporter, please.

STATEMENT OF PAUL V. McNUTT, FORT WAYNE JOURNAL-GAZETTE

Mr. McNUTT. My name is Paul V. McNutt. I am an attorney at law with offices at 84 William Street, New York, and in the Barr Building, Washington, D. C. I am here representing the Fort Wayne Journal-Gazette as a principal and not as an attorney, being one of the three trustees holding a majority of the stock of that corporation, in which I have had a substantial interest now for over 17 years.

The matter presently before you is H. R. 4473, which has no relief provision dealing with average base period net income.

The problem which I present has to do with two or more corporations which consolidated a majority of their operational facilities after December 31, 1946, and prior to July 1, 1950.

Unless relief is given to the corporations, they will be subjected to an excessive and discriminatory tax not in keeping with the original declared purpose of excess profits tax provisions, which was to prevent the accumulation of excessive wartime profits.

The facts are these:

On March 13, 1950, the Fort Wayne Journal-Gazette, a morning newspaper, and the Fort Wayne News Sentinel, an evening newspaper, effected a consolidation of their mechanical, circulation, advertising, and accounting departments, but leaving the editorial departments of each newspaper as completely separate and independent as they were prior to the consolidation. Both newspapers have a combined daily circulation of approximately 150,000 subscribers, and the Fort Wayne Journal-Gazette, which publishes the only Sunday newspaper in Fort Wayne, has a Sunday circulation of approximately 85,000 subscribers.

The consolidation was brought about primarily in order to effect savings in operation which had become essential by reason of the gradually increasing cost of operation caused by increases in wages, increases in the cost of newsprint and other items which enter into the publication of newspapers.

The consolidation, as I have set forth, has resulted in substantial savings to each newspaper, and these savings are gradually being reflected in increased profits.

By reason of the fact that the consolidation occurred in 1950, the Excess Profits Tax Act of 1950 contains no provisions under which relief could be granted either of the newspapers by reason of these increased savings, and if these corporate corporations are to obtain the relief which they are clearly entitled to, it must be by an amendment to the act which will recognize such special situations.

A proposed amendment which will afford relief in such cases is submitted for your consideration, and because there is no section 459 in H. R. 4473, and only for that reason, such a section number could be used for this amendment. The important part of the amendment—and I ask leave of the committee to make it a part of the record, the whole amendment apart of the record, is——

Senator HOEY. Yes.

Mr. McNUTT. That the average base period net income determined under this section shall be computed as follows: By computing the aggregate excess profits net income for the total period following the month in which such consolidation occurred, and ending June 30, 1951.

Senator HOEY. The whole amendment may be inserted in the record.

Mr. McNUTT. Thank you.

(The amendment referred to follows:)

AVERAGE BASE PERIOD NET INCOME CHANGE IN OPERATIONS

(a) IN GENERAL.—In the case of any two or more corporations which consolidated a majority of their operational facilities after December 31, 1946, and prior to July 1, 1950, whether or not the corporations were also merged, the average base period net income determined under this section shall be the amount computed under subsection (b).

(b) AVERAGE BASE PERIOD NET INCOME.—The average base period net income determined under this section shall be computed as follows:

(1) By computing the aggregate excess profits net income for the total period following the month in which such consolidation occurred and ending June 30, 1951.

(2) By dividing the amount ascertained under paragraph (b) (1) by the number of calendar months included in said period.

(3) By multiplying the amount obtained under paragraph (b) (2) by twelve. The amount so ascertained shall be considered the average base period net income for the purpose of determining the excess profits tax.

Mr. McNUTT. Our accountant estimates that the net profits before taxes for 1951 will be $350,000.

Under the 1950 act the normal and surtax, at 47 percent, would be $164,500.

Also under the 1950 act for excess-profits-tax purposes our average earning base is estimated at $200,000.

Senator TAFT. Is that the two put together?

Mr. McNUTT. No; I am talking only of the Journal-Gazette, Senator.

Senator TAFT. You get an allowance for the paper that is consolidated with it.

Mr. McNUTT. I understand, but this is the actual net result flowing out of that.

This would leave the amount of $150,000 upon which it would be necessary to pay excess-profits tax at the rate of 30 percent or in the sum of $45,000. Thus, the present tax under the 1950 act would be $209,500.

Under the relief amendment which we are requesting, the average earning base would be $275,000 instead of $200,000 as it now is. Therefore the amendment which we request would increase the average earning base from $200,000 to $275,000, and would save this year the excess-profits tax upon $75,000 or the sum of $22,500. That is only for the Journal-Gazette.

For the News Sentinel, while I do not have the exact figures, the accountant has estimated that the excess-profits-tax saving of the News Sentinel under this new amendment would be approximately $50,000.

To put it briefly, gentlemen, here is the case of a consolidation being made in order to effect savings and savings are effected.

The corporations now are being punished in such a law as this, and there should be some provision for relief, such relief as the corporations are entitled to.

We recognize the necessity for paying taxes. Our point is the distribution of those taxes should be equitable, and there should be some provision for relief in those cases which indicate relief.

Thank you very much, gentlemen.

Senator HOEY. We are very glad to have you make this presentation.

Senator CONNALLY. Mr. Chairman, I want to ask whether Mr. Williams of the Monsanto Chemical Co. is present?

Mr. WILLIAMS. Yes, sir.

Senator CONNALLY. I cannot remain because I have got to attend a meeting of the Foreign Relations Committee, which is having a meeting this morning, and I am chairman. I have to be there, but I want to call attention to Mr. Williams and his testimony regarding the Monsanto Chemical Co.

Have you got a plant at Texas City?

Mr. WILLIAMS. Yes, sir.

Senator CONNALLY. This is the place—Texas City is the place—that had that great disaster when those ships exploded there in the port and 147, I believe it was, people were killed; is that correct?

Mr. WILLIAMS. Correct—147 of our people, Senator.

Senator CONNALLY. Yes: 147 of the Monsanto Chemical Co. people were killed, and their plant was thoroughly and wholly destroyed so that I ask the committee to hear Mr. Williams and give him careful attention with respect to the matters he presents in regard to a relief provision to cover cases of that kind.

Senator HOEY. We will be glad to hear him.

Would you like him to be called right now?

Senator CONNALLY. Would you like to come on right now?

Mr. WILLIAMS. Yes, sir.

Senator HOEY. All right, Mr. Williams.

Senator CONNALLY. I apologize for having to leave, Mr. Williams.

Mr. WILLIAMS. Thank you very much.

Senator CONNALLY. I have tried to give you a good hearing here. I think that the committee will pay careful consideration and attention to your statement.

Senator HOEY. Mr. Williams, give your name and identification for the record, please, sir.

STATEMENT OF FELIX N. WILLIAMS, VICE PRESIDENT AND DIRECTOR, MONSANTO CHEMICAL CO.

Mr. WILLIAMS. Mr. Chairman, and gentlemen, I am Felix N. Williams, vice president and director of Monsanto Chemical Co., and director of the Manufacturing Chemists Association.

You are good enough to let me discuss with you today a situation under the Excess Profits Tax Act which result in excessive and discriminatory taxes for each year of the present emergency upon those companies which, like Monsanto Chemical Co., suffered during the base period from a major catastrophe or disaster.

In the spring of 1947, Monsanto's Texas City, Tex., plant was producing styrene monomer (which I shall hereafter call "Styrene") at a constantly increased rate.

Styrene monomer is a chemical which I shall refer to from now on as "Styrene."

The styrene went not only into the peacetime synthetic rubber program; it was also polymerized there at the Texas City plant into polystyrene, a plastic, or shipped to Monsanto's polymerization facilities at Springfield, Mass., were it was like wise transformed into polystyrene and then sold to the rapidly growing plastics industry. The Springfield unit was completely dependent upon the Texas City plant for styrene, its basic raw material.

On April 16, 1947, a ship loading ammonium nitrate and other cargo at docks of the Texas City Terminal Railway, adjoining the Monsanto Texas City plant, caught fire and exploded violently. Some hours later another ship, having caught fire from debris of the first, likewise exploded. These two large explosions produced the Texas City disaster. It resulted in 560 deaths, over 1,000 personal injuries, and in excess of $100,000,000 of property damage. The Monsanto plant and inventories were completely destroyed and 147 of its trained personnel were killed. Others were injured, some permanently. The total measurable loss to Monsanto was approximately $50,000,000.

As a result of that catastrophe, Monsanto's styrene production was completely stopped and its polystyrene output very seriously curtailed.

The company, after a prodigious rebuilding effort, recommenced styrene production in a small way in its new Texas City plant in August 1948—16 months after the disaster. But the loss of Monsanto was staggering. It did not recover from the blow during the rest of its base period, ending December 31, 1949.

Senator CONNALLY. Mr. Chairman, I am going to have to go now on account of this other committee of which I am chairman, but I am very greatly interested in this witness and his testimony because of the tremendous tragedy that resulted in Texas City from these destructions, and the loss of life and the loss of property, and I commend the witness' testimony to the committee and hope that it will pay good attention.

Mr. WILLIAMS. Thank you, Senator.

Senator HOEY. You may proceed, sir.

Mr. WILLIAMS. Because of the Texas City plant's destruction, former polystyrene customers took all or a part of their styrene business elsewhere or built their own facilities.

At the time of the disaster, Monsanto produced 35 percent of the total styrene being manufactured in the United States.

As a result of the explosion its share of the national output dropped to 10 percent for the year 1947 and the year 1948. In 1949 with the Texas City plant back in full production, Monsanto was able to bring its production back to only 28 percent of the National output, but despite every possible effort did not approach its former position in the industry.

The story of the company's polystyrene production is the same, only worse. Not only did the disaster destroy the polystyrene unit at Texas City along with all the styrene facilities, it resulted also in a great curtailment of the company's completely dependent Springfield, Mass., polymerization operations. And those operations which continued were at greatly increased cost.

In order to attempt to reduce the extent of its loss from the disaster and to fill as many of its polystyrene sales commitments as possible until the Texas City plant was rebuilt and in operation again, Springfield was forced to purchase as much styrene as it could obtain in the open market here and in Canada at prices well above what it cost Monsanto to manufacture the material at Texas City. Yet even at higher prices it could not satisfy its requirements. The loss in gross profits to the company through the purchase of materials at these excessive costs amounted to more than $2,000,000 in 1947, and more than $1,250,000 in 1948.

But that is only the smaller part of the polystyrene loss. At the time of the Texas City disaster Monsanto manufactured approximately 58 percent of the total national annual rate of polystyrene about 115,000,000 pounds.

As a result of the disaster, however, the company's percentage of the total United States production dropped to 20 percent in 1948. After getting Texas City back into production Monsanto's share of the total produced rose to only 32 percent in 1949 or 26 percent short of the predisaster figure of 58 percent.

Senator KERR. What was the national output in 1949?

Mr. WILLIAMS. 1949 approximately 200,000,000 pounds.

Senator KERR. Then your total production was almost back to the other level.

Mr. WILLIAMS. That is right.

Our total production in 1949 was back up to the level of the disaster period but the industry had risen

Senator KERR. Your reduced percentage was due in part to the over-all production going forward so rapidly.

Mr. WILLIAMS. That is part of the case, sir. But had the disaster not occurred, we would have increased our production in keeping with the industry, and we feel it would have kept our total percentage participation at the level that it was at the time of the disaster, because at the time we were rebuilding this destroyed plant, our manpower would have been used in building additional facilities.

Senator KERR. Yes, sir.

Mr. WILLIAMS. It is certainly reasonable to assume that at the least Monsanto would have maintained its position in the styrene and polystyrene industries from the date of the disaster in 1947 through the balance of the base period years. Its normal styrene sales, without the catastrophe, would have totaled $36,750,000 for the years 1947 through 1949, instead of $20,250,000 which they actually were due to the disaster.

Monsanto's normal polystyrene sales for the same years likewise absent the catastrophe, would have been $69,700,000 rather than depressed actual sales of $40,500,000. In point of fact, polystyrene production has never caught up with the demand since it first became generally available to the public.

Senator MILLIKIN. I may have missed part of the testimony. What is polystyrene?

Mr. WILLIAMS. Polystyrene, sir, is a plastic material used in the plastics industry for injection molding, in the making of such items as refrigerator parts, radio cases, housewares and many, many other items. It is one of the newest and one of the most rapidly growing plastic materials.

Senator MILLIKIN. Thank you very much.

Mr. WILLIAMS. As a result of being an innocent victim of the worst industrial catastrophe in our country's history, Monsanto's net sales for the year 1947–49 averaged $150,000,000, $12,500,000 per year less than they would normally have been. Its net income before taxes averaged $26,850,000 for each of those three base period years instead of normal average net income of $33,000,000 had the disaster not occurred.

Monsanto's excess profits tax credit based on normal base period earnings, without the devastating effect of a catastrophe like Texas City would have been $31,500,000. However, the maximum credit of which the company can be certain under the present law will be only $26,000,000, or a loss of a base of $5,500,000.

Gentlemen, in the interest of saving your time I will not read the balance of my memorandum, but will summarize it by saying that it sets forth the reasons why the relief provisions are inadequate.

It also suggests a method by which the present law can be amended in order to grant appropriate relief.

Monsanto should pay, and is quite willing to pay its just share of the tax burden, but we believe you will agree that it is unfairly penalized by the present law.

Thank you very much.

Senator HOEY. Thank you very much, Mr. Williams. It is good to have had your testimony.

Your entire statement will be placed in the record at this point.

Mr. WILLIAMS. Thank you, sir.

(The prepared statement of Mr. Felix Williams is as follows:)

STATEMENT BY FELIX N. WILLIAMS, MONSANTO CHEMICAL CO.

Mr. Chairman and gentlemen, I am Felix N. Williams, vice president and director of Monsanto Chemical Co. and a director of the Manufacturing Chemists Association. You are good enough to let me discuss with you today a situation under the excess-profits tax law which results in excessive and discriminatory taxes for each year of the present emergency upon those companies which, like Monsanto Chemical Co., suffered during the base period from a major catastrophe or disaster.

In the spring of 1947, Monsanto's Texas City, Tex., plant was producing styrene monomer [1] (which I shall hereafter call styrene) at a constantly increasing rate. The styrene went not only into the peacetime synthetic rubber program; it was also polymerized there at the Texas City plant or shipped to Monsanto's other polymerization facility at Springfield, Mass., where it was likewise transformed into polystyrene and then sold to the rapidly growing plastics industry.[2] The Springfield unit was completely dependent upon the Texas City plant for styrene, its basic raw material.

On April 16, 1947, a ship loading ammonium nitrate and other cargo at docks of the Texas City Terminal Railway, adjoining the Monsanto Texas City plant, caught fire and exploded violently. Some hours later another ship, having caught fire from debris of the first, likewise exploded. These two large explosions produced the Texas City disaster. It resulted in 560 deaths, over 1,000 personal injuries, and in excess of $100,000,000 of property damage. The Monsanto plant and inventories were completely destroyed, and 147 of its trained personnel were killed. Others were injured, some permanently. The total measurable loss to Monsanto was approximately $50,000,000.

As a result of that catastrophe, Monsanto's styrene production was completely stopped and its polystyrene output very seriously curtailed. The company, after a prodigious rebuilding effort, recommended styrene production in a small way

[1] Styrene monomer is formed from ethylbenzene, a chemical produced from coal tar and petroleum derivatives.

[2] Polystyrene is a plastics product formed by polymerizing styrene monomer. Polymerization is the reaction in which two or more units of a substance combine with each other to form a product of new and different properties.

in its new Texas City plant in August 1948—16 months after the disaster. But the loss of Monsanto was staggering. It did not recover from the blow during the rest of its base period, ending December 31, 1949. Because of the Texas City plant's destruction, former polystyrene customers took all or a part of their styrene business elsewhere or built their own facilities.

Under the most favorable provision of the present law which the company is certain will apply, Monsanto's 1950 excess-profits tax credit will be only $26,000,000, less than half its $55,000,000 profits before taxes for 1950. The credit would have been at least $31,600,000 if the Texas City disaster had not occurred. Therefore, unless additional relief is provided, $5,500,000 of normal earnings will be subject to excess-profits taxes each year for the duration of the emergency.

At the time of the disaster, Monsanto produced 35 percent of the total annual rate of 368,000,000 pounds being manufactured in the United States. As a result of the explosion, its share of the national output dropped to 10 percent for the year 1947 and 1948. In 1949, with the Texas City plant back in full production, Monsanto was able to bring its production back to only 28 percent of the national output, but despite every possible effort did not approach its vormer position in the industry.

The story of the company's polystyrene production is the same, only worse. Not only did the disaster destroy the polystyrene unit at Texas City along with all the styrene facilities, it resulted also in a great curtailment of the company's completely dependent Springfield, Mass., polymerization operations. And those operations which continued were at greatly increased cost.

In order to attempt to reduce the extent of its loss from the disaster and to fill as many of its polystyrene sales commitments as possible until the Texas City plant was rebuilt and in operation again, Springfield was forced to purchase as much styrene as it could obtain in the open market here and in Canada at prices well above what it cost Monsanto to manufacture the material at Texas City. Yet even at higher prices it could not satisfy its requirements. The loss in gross profits to the company from such purchases was more than $2,000,000 in 1947, and more than $1,250,000 in 1948.

But that is only the smaller part of the polystyrene loss. At the time of the Texas City disaster Monsanto manufactured approximately 58 percent of the total national annual rate of polystyrene, about 115,000,000 pounds. As a result of the disaster, however, the company's percentage of the total United States production dropped to 29 percent in 1948. After getting Texas City back into production, Monsanto's share of the total produced rose to only 32 percent in 1949—or 26 percent short of the predisaster figure of 58 percent.

It is certainly reasonable to assume that at the least Monsanto would have maintained its position in the styrene and polystyrene industries from the date of the disaster in 1947 through the balance of the base period years. Its normal styrene sales, without the catastrophe, would have totaled $36,750,000 for the years 1947 through 1949, instead of $20,250,000 which they actually were due to the disaster. And its normal polystyrene sales for the same years, likewise absent the catastrophe, would have been $69,700,000 rather than depressed actual sales of $40,500,000. In point of fact, polystyrene production has never caught up with the demand since it first became generally available to the public.

As a result of being an innocent victim of the worst industrial catastrophe in our country's history, Monsanto's net sales for the years 1947–49 averaged $150,000,000, $12,500,000 per year less than they would normally have been. Its net income before taxes averaged $26,850,000 for each of those three base period years instead of normal average net income of $33,000,000 had the disaster not occurred.

Monsanto's excess-profits tax credit based on normal base period earnings, without the devastating effect of a catastrophe like Texas City, would have been $31,500,000. However, the maximum credit of which the company can be certain under the present law will be only $26,000,000—and under the recently passed House bill, Monsanto's credit for base period earnings would be reduced to $23,400,000 for 1951 and thereafter.

Monsanto might qualify under section 442, the relief provision dealing with "abnormalities" during the base period. However, we do not believe that a circumstance of such broad scope and far-reaching effect as a major catastrophe or disaster could have been intended by the Congress as being within the scope of this section. Section 442 gives relief to a taxpayer whose business is affected by situations unusual in its experience, but not so extremely unlikely to occur or so terribly devastating in the life of the average corporation as the Texas City catastrophe. The Ways and Means Committee report on the excess-profits tax bill gives a severe price war as an example of the kind of abnormality which would enable a taxpayer to use section 442. Possibly a serious shortage of materials might be such an abnormality also. The conferees' summary of H. R. 9827 cites physical interruptions to production, such as a fire, strike, or flood or other typically temporary abnormal situations. Nowhere does it appear that a major catastrophe of the magnitude and size of the Texas City disaster, which devastated a large part of the city, laid waste its industry, and caused property damage in excess of $100,000,000, was in the contemplation of Congress when it enacted section 442.

In any event, much will depend upon the severity or liberality of the Treasury Department's interpretation of that section. The taxpayer cannot be certain of needed relief.

Then, too, the credit allowed under section 442 would be measured by the chemical industry's rate of return (as promulgated by the Treasury) upon the average of Monsanto's total assets as of the end of each year of the base period. Such a credit would be unrealistic and penalizing: Monsanto has through the years maintained a higher rate of return than the average of the chemical industry. That same higher percent of income would also have existed during all of the base period years had the Texas City catastrophe not destroyed the company's plant and substantially reduced its over-all production and sales. A credit based on the customarily lower industry rate of return during any normal peacetime period would thus inevitably result in compounding the serious hurt which Monsanto suffered from the Texas City explosions.

Therefore, without additional relief for taxpayers suffering from major catastrophe or disaster, each year of the emergency Monsanto will not only pay excess-profits taxes on all earnings attributable to the defense program, but on at least $5,500,000 of its normal peacetime earnings as well.

To remedy such an inequitable and unintended situation, Monsanto urges the amendment of section 435 by adding a specific alternative average base period net income relief formula for use when a major catastrophe has materially affected the taxpayer's normal earnings during the base period.

The standards which the taxpayers suffering from disaster must meet in order to qualify for relief should be high. Thus, a corporation would be entitled to use the benefits of the proposed relief section only if all of the following three tests are met:

(1) A catastrophe or disaster wholly or substantially destroyed or rendered inoperative a production facility of the taxpayer having a tax basis equal to 15 percent or more of all the taxpayer's production facilities; and

(2) As a result for more than 12 months thereafter, taxpayer's normal production or operation was substantially interrupted and its earnings materially lessened; and

(3) Prior to the end of its base period, taxpayer replaced the destroyed or inoperative facility with one having at least the same tax basis.

Having met those requirements, the corporate taxpayer would then be entitled to include in its average base period net income computed under the present section 435 (d):

(1) The additional income which it would have earned had its plant not been destroyed and had it continued to manufacture and sell during the balance of the base period the same portion of the total national output as it had at the time of the catastrophe; and

(2) The taxpayer's unusual and nonrecurring expenses incurred for the purpose of decreasing or mitigating its loss of earnings due to the disaster.

In that way the pattern of the present law is followed. The principle of old section 722 is adopted, but its well-known pitfalls are avoided by spelling out tests for eligibility for relief and a specific formula for determining the amount of relief.

The memorandum which has been handed to you and which is being filed with the staff contains an appendix setting forth detailed language for the proposed amendment to section 435. An alternative to such a relief formula, if Congress should decide not to enact further specific relief provisions, would be the reenactment of a general relief provision similar to the old section 722. In such case, however, there should be written into the law specific statutory standards for qualification for relief and for measuring the scope of the relief to be allowed, in order to eliminate so much of the difficulty experienced under the administration of section 722. The memo which you have before you also contains detailed recommendations with respect to such a general relief provision.

Monsanto and every company like it which has suffered from a major catastrophe should pay and is willing to pay its fair share of the tax burden. However, no such company should be penalized with excessive and inequitable taxes resulting in serious additional economic and competitive disadvantages to it. That result will inevitably follow the application of the present Excess Profits Tax Act to corporations suffering very severe setbacks due to a major disaster. The Congress should, therefore, write into the law clear statutory standards for aiding such taxpayers. Otherwise, the earnest congressional desire to provide adequate relief for taxpayers experiencing unusual and depressing circumstances would be frustrated and a large share of such corporations' normal peacetime earnings will be subjected to an unintended and unjust tax burden.

Need for Excess Profits Tax Relief To Avoid Excessive Taxation of Corporations Suffering Major Catastrophe or Disaster

(Monsanto Chemical Co.)

SUMMARY

1. In April 1947, Monsanto's Texas City styrene production plant was completely destroyed and 145 of the company's trained personnel were killed when two nearby ships exploded causing the Texas City disaster, America's worst industrial catastrophe. The total measurable loss to Monsanto, an innocent victim, was approximately $50,000,000.

2. At the time of the disaster, Monsanto manufactured 35 percent of the total national production of styrene monomer, the basic ingredient for Buna S synthetic rubber and for polystyrene plastics and 58 percent of the total national output of polystyrene plastics for the rapidly expanding plastics-fabricating industry.

3. As a result of the explosions, Monsanto's proportion of the total national production dropped to 10 percent for styrene monomer and 29 percent for polystyrene.

4. Had the Texas City disaster not occurred, Monsanto's average base-period net income would have been $33,000,000; its excess-profits-tax credit $31,500,000.

5. However, its excess-profits-tax credit under the present law will be only $26,000,000. (Under the amendment proposed by the Ways and Means Committee, the credit for base-period earnings would be only $23,400,000 for 1951 and thereafter.)

6. Without additional relief for taxpayers suffering from major catastrophe or disaster, Monsanto will not only pay excess-profits taxes on all earnings attributable to the defense program, but on $5,500,000 of its normal peacetime earnings as well.

I. PROBLEM

The 1950 excess-profits tax was intended to apply to corporate profits which were swollen by the increased tempo of the war economy. Congress recognized, as it had in the World War II act, that its taxing provisions, no matter how carefully chosen, would result in excessive and discriminatory taxation as applied to many corporations. Instead of providing a general relief provision for these cases, similar to section 722 of the earlier statute, it prescribed rigid formulas for determining the amount of relief and inflexible standards in defining eligibility for relief.

When queried on the floor of the Senate concerning the absence of a section 722, Senator George said:

"The present bill approaches the same problem but undertakes to spell out relief for new corporations formed after the base period began, for depressed industries, for companies having abnormalities, and for other corporations which we thought were entitled to relief. Whether the committee has gone far enough and whether those relief provisions will be altogether effective, of course, remains to be demonstrated or disproved in the administration of the act."

Monsanto Chemical Co. is a striking example of the inadequacies of the present law's relief provisions. It was a victim of the Texas City disaster, the worst industrial catastrophe in American history. Yet, section 442, the section which is designed to give relief to taxpayers suffering from abnormalities in their business, fails to provide fair and adequate tax relief for Monsanto or others who have suffered a great calamity. It results in the imposition of excessive and discriminatory levies on corporations which are striving to overcome the devastating effects of an act of God or other major catastrophe.

In the spring of 1947, Monsanto's Texas City, Tex., plant was producing styrene monomer[1] (hereinafter called styrene) at a constantly increasing rate. The styrene went not only into the important peacetime synthetic-rubber program; it was also polymerized at the Texas City plant or shipped to Monsanto's other polymerization facility at Springfield, Mass., where it was likewise transformed into polystyrene and sold to the rapidly growing plastics industry.[2] The Springfield unit was completely dependent upon the Texas City plant for styrene, its basic raw material.

The Texas City Disaster

On April 16, 1947, two ships were loading ammonium nitrate and other cargo at docks of the Texas City Terminal Railway, adjoining the Monsanto Texas City plant. Monsanto had no interest in the ammonium nitrate, the ships or the docks. One of the ships caught fire and exploded violently. Some hours later the other ship, having caught fire from debris of the first, likewise exploded. These two large explosions produced the Texas City disaster. It resulted in 560 deaths, over 1,000 personal injuries, and in excess of $100,000,000 of property damage. The Monsanto plant and inventories were destroyed, and 145 of its trained personnel were killed. Others were injured, some permanently. The total measureable loss to Monsanto was approximately $50,000,000.

As a result of the Texas City disaster, Monsanto's styrene production was completely stopped and its polystyrene production very seriously curtailed. The company, after a prodigious rebuilding effort, recommenced styrene production in a small way in its new Texas City plant in August 1948—16 months after the catastrophe. But Monsanto's loss of position in the competitive markets was staggering. It has not yet recovered from the blow. Because of the Texas City plant's destruction, former polystyrene customers took all or a part of their styrene business elsewhere or built their own facilities. Despite an intense rebuilding program and energetic efforts to maintain production and sales of polystyrene in the Springfield plant of the company, Monsanto was unable to overcome the seriously deterring effects of the Texas City catastrophe during the balance of its excess-profits-tax base period ending December 31, 1949.

Under the most favorable provision of the present law which the company is certain will apply, Monsanto's 1950 excess-profits-tax credit will be only $26,000,000, less than half its $55,000,000 profits before taxes for 1950. The credit would have been $31,500,000 if the Texas City disaster had not occurred. Unless additional relief is provided, therefore, $5,500,000 of normal earnings will be subject to excess-profits taxes each year for the duration of the emergency.

Certainly Congress did not intend to place a corporation which has suffered from a catastrophe of major proportions under such serious additional economic and competitive disadvantages and subject such a large share of its normal peacetime earnings to an inequitable and unjust tax burden. In fact, it appears from the legislative history of the excess-profits-tax law that Congress desired and earnestly sought to provide adequate relief for taxpayers experiencing unusual and peculiarly depressing circumstances.

Senator George on the floor in the closing debate on the bill with particular reference to the absence of a general relief provision such as section 722 confirms our belief:

"Whether these formulas (the new relief formulas) will adequately meet these situations, of course the committee cannot say. We only express the hope that they will, and we have taken the extraordinary step of providing for the rewriting of this bill by the end of December 1952, in order that we may meet the problems which, through experience, are then presented to us in a clearer light in the very brief hearing the committee was able to hold on this bill."

This memorandum is submitted to demonstrate that the rigid and exclusive formulas provided in the Excess Profits Tax Act of 1950 do not adequately meet major catastrophe and disaster situations, which seriously affect the earnings of a corporate taxpayer. Additional relief provisions are required if Congress is to avoid an unintended inequity in this, and, no doubt, a good number of other cases were either the rules of eligibility or the extent of the relief provided result in taxing as excess profits an undue and excessive percentage of normal earnings.

Such provisions need not await a rewriting of the bill at the end of December 1952. They should be provided now to meet the basic intent and desire of Congress.

[1] Styrene monomer is formed from ethyl benzene, a chemical produced from coal tar and petroleum derivatives.

[2] Polystyrene is a plastics product formed by the polymerization of styrene monomer. Polymerization is the reaction in which two or more units of a substance combine with each other to form a product of new and different properties.

II. UNFAIRNESS OF THE 1950 EXCESS-PROFITS TAX LAW AS APPLIED TO MONSANTO CHEMICAL CO.

The extent of Monsanto's loss of earnings due to the Texas City disaster, and the failure of the present relief provisions to make adequate adjustment in the company's tax credit for the effects of the catastrophe, demonstrate conclusively the unfairness of the provisions of the present law. Normal earnings which Monsanto would have had in 1947, 1948, and 1949, had not its plant and personnel been lost in the disaster, are being treated as excessive: the resulting tax under the 1950 act is inequitable and unjust.

Styrene

The principal products which result from styrene, namely synthetic rubber and polystyrene plastics, have become generally available to the public anly since World War II. To meet constantly increasing demands for styrene and polystyrene, as well as for all of its other products, Monsanto invested more than $107,000,000 in buildings and equipment during the base period, more than doubling its plant and facilities. During the same period its sales rose from $86,000,000 to $160,000,000, an increase of 86 percent.

The styrene portion of its business, however, went in the opposite direction due to the Texas City disaster.

Prior to the explosions on April 16, 1947, Monsanto was producing at Texas City 35 percent of the total national production of styrene. The company's plant was rebuilt and put into limited operation in August 1948. Because of the disaster, Monsanto's share of the national production was only 11.8 percent in 1947, and only 10 percent in 1948. In 1949, its production amounted to 28 percent of the national total, but despite every possible effort did not approach its former position in the industry.

The following tabulation shows what happened to Monsanto's styrene production as a result of the disaster:

	Styrene monomer (in pounds)		Monsanto percent of national
	Total national production	Monsanto production	
First quarter 1947	92,000,000	32,000,000	35
Year 1947	311,000,000	37,000,000	11.8
Year 1948	377,000,000	37,500,000	10
Year 1949	390,500,000	110,000,000	28

Monsanto's actual styrene sales reacted accordingly. They are shown below in comparison with Monsanto's normal sales, had the catastrophe not destroyed the plant, based upon the reasonable assumption that the company would continue to obtain its pre-Texas City disaster share of the national market:

	Monsanto actual net sales	Monsanto normal net sales
First quarter 1947	[1] $2,500,000	2,500,000
Year 1947	3,000,000	7,500,000
Year 1948	4,250,000	9,250,000
Year 1949	13,000,000	20,000,000

[1] Monsanto's actual sales of styrene for the first quarter of 1947, when annualized, would result in sales of $10,000,000 for 1947, in contrast with actual sales of $3,000,000 for the year.

Polystyrene

The Texas City disaster destroyed not only Monsanto's styrene plant, but also its polymerization facilities at Texas City. In addition, the operation of its Springfield, Mass., polymerization facilities, which depended upon Texas City for its basic raw material, were greatly curtailed; those operations which continued were at greatly increased cost.

Monsanto is one of a highly competitive group of producers who vie for position as chief supplier in the rapidly expanding polystyrene plastics fabricating industry. In order, therefore, to attempt to reduce the extent of its loss from the disaster and to fill as many of its polystyrene sales commitments as possible until the Texas City plant was rebuilt and in operation, Springfield was forced to purchase styrene in the open market here and in Canada at prices well above what it cost Monsanto to manufacture the material at Texas City. The loss in gross profits to the company from this additional source was more than $2,000,000 in 1947, and more than $1,250,000 in 1948.

But that is only the smaller part of the polystyrene loss. At the time of the Texas City disaster, this country was producing polystyrene at the annual rate of about 115,000,000 pounds, and Monsanto was manufacturing approximately 58 percent of it. As a result of the disaster, however, the company's percentage of the total national production for the balance of 1947 dropped to 41.5 percent. It was only 29 percent in 1948. After getting Texas City back into production, Monsanto's share of the total produced rose to 32 percent in 1949—still a long way from the predisaster figure of 58 percent.

It is reasonable to assume that Monsanto would at the least have maintained its position in the polystyrene industry during the balance of the base period years. Its normal sales, absent the catastrophe, would have been as shown in the last column of the tabulation set forth below:

Styrene and styrene derivative polymers and copolymers for molding

	Total national production (pounds)	Monsanto production (pounds)	Monsanto percent of national	Monsanto loss in gross profits	Monsanto actual net sales	Monsanto normal net sales
First quarter 1947	22,000,000	12,700,000	58	....	$3,700,000	$3,700,000
Second to fourth quarters 1947	74,500,000	31,000,000	41.5	$2,000,000	8,300,000	12,500,000
Year 1947	96,300,000	41,600,000	43	2,000,000	12,000,000	16,200,000
Year 1948	145,300,000	42,800,000	29	5,200,000	12,500,000	25,000,000
Year 1949	179,400,000	58,300,000	32.5	6,000,000	16,000,000	28,500,000

The following table shows what the company's normal net sales and earnings during the base period would have been, had the company not been a victim of the Texas City catastrophe:

	Net sales		Net income (before taxes)	
	Actual	Normal	Actual	Normal
1946	$89,000,000	$89,000,000	$15,500,000	$15,500,000
1947	136,000,000	144,000,000	24,000,000	29,000,000
1948	153,500,000	170,500,000	28,500,000	36,000,000
1949	160,500,000	173,000,000	28,000,000	34,250,000
Average, 1947–49	150,000,000	162,500,000	26,850,000	33,000,000

But let us see what credit is allowed to Monsanto under the 1950 Excess Profits Tax Act.

(*a*) *Inadequacy of the earnings credit* (*sec. 435* (*d*))

This credit is based primarily upon the average net income of the best three of the base period years, 1946 to 1949. The credit which Monsanto would get under this section is only $26,000,000, as compared with a credit of $31,500,000 based on the average net income of the three best normal years in the base period, had the Texas City disaster not occurred.[3]

(*b*) *Inadequacy of the invested capital credit* (*sec. 436*)

Monsanto's credit based on invested capital is an even poorer measure of earnings. It would be only $11,000,000, despite the fact that the company's average base period net income for 1947 through 1949, had the Texas City catastrophe not occurred, would have been in excess of $33,000,000. The present invested capital credit amounts to a return of only 6 percent before taxes—and only 3.5 percent after normal and surtax of 42 percent—upon the company's

[3] For 1951 and subsequent years the credit attributable to base period earnings would be reduced from $26,000,000 to $23,400,000 under the amendment proposed by the Ways and Means Committee in the forthcoming Revenue Act of 1951. This amendment allows only 75 percent instead of 85 percent of the average net income of the three best base period years.

equity and borrowed capital. It goes without saying that such a low rate of return is entirely unrealistic for a dynamic chemical company creating new products and developing broad new markets and demands. It is also obvious that this method for determining the tax credit does not result in a fair and reasonable standard of normal earnings for the taxpayer who is experiencing any business growth.

(c) *Inadequacy of the relief provision based on abnormalities during base period (sec. 442)*

Monsanto might qualify under this section on the ground that its normal production, output or operation was interrupted or diminished because of the occurrence during its base period of an event unusual and peculiar in its experience, i. e., the Texas City disaster. Or it may qualify on the ground that its business was depressed because of temporary economic circumstances unusual in its experience, again resulting from the disaster. Certainly the abnormality affected Monsanto well in excess of 12 months.

However, we do not believe that a circumstance of such broad scope and far-reaching effect as a major catastrophe or disaster could have been intended by the Congress as being within the scope of this section when it enacted the 1950 excess profits tax law. Section 442 was designed to give relief to taxpayers whose business is affected by situations unusual in its experience, but not so extremely unlikely to occur or so terribly devastating in the life of the average corporation—or in a community's history—as the Texas City catastrophe. The House Ways and Means Committee report on the excess profits tax bill gives a severe price war as an example of the kind of abnormality which would enable a taxpayer to use section 442. Possibly a serious shortage of materials might be such an abnormality also. The conferees' summary of H. R. 9827 cites physical interruptions to production, such as a fire, strike, or flood or other typical temporary abnormal situations. Nowhere does it appear that a major catastrophe of the magnitude and size of the Texas City disaster, which devastated a large part of a city, laid waste its industry, including the Monsanto plant, killed 560 people, injured over 1,000 more and caused property damage in excess of $100,000,000, was in the contemplation of Congress when it enacted section 442 to give relief for abnormalities during base period.

In any event, much will depend upon the severity or liberality of the Treasury Department's interpretation of section 442. The taxpayer cannot be certain of needed relief.

Then, too, the credit allowed would be measured by the chemical industry's rate of return (as promulgated by the Treasury) upon the average of Monsanto's total assets as of the end of each year of the base period. The company's credit under this section would be only $28,500,000 as compared with normal average earnings before taxes of $33,000,000 for the years 1947 through 1949, had the catastrophe not destroyed Monsanto's Texas City plant. Certainly a credit of $28,500,000 would be most unrealistic and inadequate, even if the company were certain to obtain it. Such a base would result in an excessive and discriminatory excess-profits tax upon normal earnings of the taxpayer.

III. PROPOSED ADDITIONAL RELIEF PROVISIONS

The Monsanto case is unusual, but certainly not unique. There are other corporate victims of the Texas City disaster—and certainly many victims of other catastrophes. But, fortunately, disasters and catastrophes in America are as few in number as they are serious and far-reaching in their economic consequences upon the corporations which are unfortunate enough to have to bear the brunt of them. Such corporate taxpayers are not protected by the relief provisions of the 1950 act. In order not to prejudice them still further economically and competitively, they should be entitled to a credit or base reflecting their normal earnings during the base period, had the catastrophe or disaster not occurred.

Such a credit could be provided by the following pattern. It could also be provided by a general relief provision similar to old section 722.

A recommended formula which would grant a fair and just credit to a corporation, the victim of a catastrophe that seriously affected its earnings in the base period, is as follows:

(a) Specific alternative average base period net income relief formula based on major catastrophe

Tests.—A corporate taxpayer should be entitled to relief if—

(1) A production facility, having basis for gain or loss equal to 15 percent or more of all the taxpayer's production facilities, was wholly or substantially destroyed or rendered inoperative by a disaster or catastrophe; and

(2) As a result, for 12 months or more the taxpayer's normal production or operation was substantially interrupted or diminished and its earnings materially lessened; and

(3) Prior to the end of its base period, taxpayer replaced the destroyed or inoperative facility with one having at least as great a basis for gain or loss.

Credit.—Add to the average base period net income computed under section 435 (d) the sum of:

(1) Taxpayer's rate of return on the products manufactured in the destroyed or inoperative facility (expressed as a percent of their sales prices) times the difference between taxpayer's actual dollar sales of such products during the balance of the base period and the sales which it would have made if taxpayer had continued to produce and sell the same portion of the total national output as it had at the time of the disaster or catastrophe; and

(2). Taxpayer's loss of profits resulting from unusual expenses incurred as a result of the facility's destruction or being rendered inoperative and for the purpose of preventing still further loss of profits.

(b) General relief provision

An alternative to such a formula, if Congress should decide not to enact further specific relief provisions, would be the reenactment of a general relief provision similar to section 722 of the World War II excess-profits tax.

To eliminate the administrative difficulties which have greatly delayed the disposition of cases under that section, however, it is recommended that Congress review the rulings and policies of the excess-profits-tax council and enact detailed clarifications of its intent.

One of the primary lapses in section 722 has been the delay, both on the part of the taxpayer and the Government, in reaching a final administrative determination. Any reenactment should require the filing of claims under the new provision within 1 year of the due date of the return for the year involved, thus requiring the taxpayer to act promptly.[4] It should also require a final administrative determination upon the claim within 1 year of its filing. Thus, if the taxpayer is not satisfied with the credit allowed, it can go promptly to the Tax Court. It must be recognized that an excess-profits tax is an emergency measure and, therefore, does not permit of processing in the normal course.

Most important, however, in order to reduce administrative judgment to a minimum, there should be written into the law statutory standards for qualification for relief and for measuring the scope of the relief to be allowed. In the case of corporations which have suffered very severe set-backs due to a major catastrophe or disaster, for example, such statutory measurements should include tests to determine whether a substantial part of the corporation's productive facilities was affected, whether the destroyed or inoperative facility was replaced by one having at least the same cost basis, and the length of time the effect was felt by the corporation on both its operations and its earnings. The tests would be similar to those in the proposed alternative relief formula based on major catastrophe. Any taxpayer meeting all of these standards would qualify for relief, at least presumptively. Administrators of the law would also be guided by these standards in granting relief to other taxpayers not able to meet them all.

The amendment should also provide that the taxpayer who qualifies and meets all the standards prescribed in the catastrophe formula would be permitted to include in its average base period net income credit, the earnings which it would have had on its share of the total national production of those products made in the destroyed plant, had the catastrophe not occurred.

Likewise, statutory standards for unusual "growth" companies to meet for needed relief should also be spelled out in the amendment. For example, a company which, during the base period, more than doubled its plant facilities and increased its sales and its net income by more than 50 percent, has certainly evidenced extraordinary growth deserving of relief beyond any now provided in the present law.

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[4] Or 1 year from the adoption of the provision, whichever is later.

Monsanto's plant more than doubled in value from January 1, 1946 ($70,000,000), to December 31, 1949 ($155,000,000). Despite the telling effect of the Texas City disaster, the company's net sales for 1950 ($200,000,000), duly discounted for the influence of the Korean War, exceeded by more than 100 percent its average net sales for the years 1945 and 1946 ($97,500,000). And again, despite the loss of its plant and some of its trained personnel in the explosions, Monsanto's net income for 1950 ($43,500,000), likewise discounted, was more than 50 percent above its average base period net income ($26,000,000).

Certainly, any general relief provision similar to section 722 should include help for a taxpayer whose extraordinary growth is established by showing that (*a*) during 1946 through 1949 it doubled the unadjusted basis of its plant and facilities; (*b*) twice its net sales for the period January 1 to June 30, 1950, was 50 percent or more above its average sales for 1945 and 1946; and (*c*) either (i) twice its excess-profits net income from January 1, 1950, to June 30, 1952, or (ii) its "weighted excess-profits net income" for its first excess-profits-tax taxable year, is 50 percent or more in excess of its average base period net income.

The credit for such remarkable growth should be based on the level of earnings reached at the end of the base period, as in the case of the "new product" relief section (sec. 435 (e)).

Thus the base for taxpayers who have reached such a new high level of sales and income at December 31, 1949, would be 85 percent of either (1) twice the taxpayer's excess-profits net income for the first 6 months of 1950, or (2) its "weighted excess-profits net income" for its first excess-profits-tax taxable year, at the taxpayer's election.

In both the major catastrophe and the extraordinary growth situations, the general relief provision would impose excess-profits taxes only on those earnings in excess of the fair and just reconstruction of normal earnings. Taxpayers would thus be permitted to show that a greater level of earnings would have been reached, as under section 722.

Similar formulas should be prescribed to establish standards of qualification and scope of relief for the other changes in business encompassed by the section. Such standards for qualification and for reconstruction should eliminate to a very great extent the administrative difficulties encountered under section 722.

APPENDIX

PROPOSED AMENDMENT PROVIDING RELIEF FROM MAJOR CATASTROPHE OR DISASTER

Section 435 should be amended by adding the following new subsection:

"(h) AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON MAJOR CATASTROPHE.

"(1) TAXPAYER TO WHICH SUBSECTION APPLIES—A taxpayer shall be entitled to the benefits of this subsection if the taxpayer commenced business before the beginning of its base period, and if—

"(A) During or immediately prior to the taxpayer's base period a production facility or facilities of the taxpayer, having an adjusted basis for determining gain or loss equal to or in excess of 15 per centum of the adjusted basis of all of taxpayer's production facilities, were wholly or substantially destroyed or rendered inoperative by disaster or catastrophe; and

"(B) As a result, for a period in excess of twelve months taxpayer's normal production, output or operation was substantially interrupted or diminished and its earnings were materially lessened; and

"(C) Prior to the end of taxpayer's base period, the construction or acquisition of a new facility or facilities for the production of the same product or products was commenced by the taxpayer, and the adjusted basis for determining gain or loss for such new facility or facilities was equal to or in excess of the adjusted basis of the former facility or facilities at the time of destruction or being rendered inoprative.

"(2) COMPUTATION.—The alternative average base period net income allowed under this subsection shall be determined as follows:

"(A) By computing (in the manner provided by the second sentence of subsection (d) (1)) the excess profits net income for each month in the base period.

"(B) By computing (in the manner provided by the second sentence of subsection (d) (1)) the 'additional excess profits net income' for each month in the base period commencing with the month in which the facility was destroyed or rendered inoperative. For the purposes of this subparagraph, the 'additional excess profits net income' shall be the sum of—

"(i) The taxpayer's normal net income from the sale or disposition of such product or products during the twelve months preceding the catastrophe, expressed as a percentage of the sales price of such product or products, multiplied by the difference between taxpayer's actual dollar sales during the balance of its base period and the dollar sales which it would have had during such period if taxpayer had continued to produce and sell the same proportion of the total national output of such product or products as it produced and sold at or shortly before the time of the disaster or catastrophe; and

"(ii) The taxpayer's unusual and nonrecurring costs and expenses incurred as a result of the facility's destruction or being rendered inoperative and for the purpose of decreasing or mitigating taxpayer's resultant loss of earnings.

"(C) By adding the amount ascertained under subparagraph (B) for each month to the amount ascertained under subparagraph (A) for the same month.

"(D) By computing (in the manner provided by subsection (d) (2)) the alternative average base period net income."

Senator HOEY. John W. Hanes.

Give your name and your connection.

STATEMENT OF JOHN W. HANES, PRESIDENT, ECUSTA PAPER CORP., ACCOMPANIED BY WALTER F. O'CONNELL, ACCOUNTANT

Mr. HANES. Mr. Chairman, and members of the committee, my name is John W. Hanes. I am president of Ecusta Paper Corp., Pisgah Forest, N. C., a wholly owned subsidiary of Olin Industries, Inc., of which I am vice president, and I appear before you today to point out a very serious inequity existing in the excess-profits-tax law of 1950 which I am convinced resulted from the shortness of time you had in which to adopt this important legislation.

The inequity is brought about by the relief provisions of the Excess Profits Tax Act.

Specifically, it affects companies which have invested capital in entirely new ventures. This inequity is of the gravest importance to the Ecusta Paper Corp.

Ecusta has been manufacturing cigarette paper since 1939. The company operated at full capacity until the middle of the year 1949. At that time production was curtailed because of the resumption of manufacture by foreign cigarette-paper manufacturers and the lack of dollar credits of the many of Ecusta's foreign customers. This created a pool of unemployed workers in Transylvania County, N. C., who were highly skilled and very desirous of obtaining employment.

Senator MILLIKIN. May I ask from what countries does this type of paper come?

Mr. HANES. This cigarette paper was originally made in France, Senator; until 1939 the largest portion of our cigarette paper came from France.

In that year we developed a method of using an American farm product, flax fiber, for the manufacture of pulp from which to manufacture cigarette paper, and since that time we brought the largest share of that cigarette-paper business to this country instead of France, as it was formerly.

Senator KERR. What market for the paper exists in the United States?

Mr. HANES. The market, the total market for cigarette paper, the largest market, of course, is in the United States. We manufacture in point of tonnage—it is very small compared to other paper manufacturers—the tonnage in this whole country of cigarette paper is somewhere in the neighborhood of 30,000 tons a year.

Senator KERR. Considerably over half of the world market is here; is it not?

Mr. HANES. I would assume so, of course, but I do not have that figure accurately in mind. I would assume that more than half of it is here.

As I said, we had quite a group of unemployed people at that part of North Carolina, due to our cut-back, and in an effort to fill this need, coupled with our desire to enter the cellophane field, the Ecusta expansion program became a reality.

In November 1949 we entered into a legally binding contract with du Pont to manufacture and sell cellophane. Negotiations for the contract commenced as early as October 1948 and, as soon thereafter as the mechanical details could be worked out, namely, March 1950, Ecusta commenced construction of a cellophane plant, involving a large investment, adjacent to its cigarette-paper plant.

The cellophane plant, to contain nine casting machines, was constructed under the guidance of du Pont engineers. The plant is at the present time almost complete and, in fact, about one-half of the machines are successfully producing cellophane. The production of cellophane at Ecusta is the culmination of long and carefully laid plans. The sale of cellophane to customers commenced in June of this year, 1951.

When we were arranging the financing of the investment in buildings and machinery, together with the necessary working capital, the corporate-tax rate was 38 percent, and none of us could foresee or even dreamed of another harsh and complicated excess-profits-tax law.

Section 443 of that law was enacted to provide relief for corporations which had made substantial changes in their products or their services during the base period. The relief in our case is necessary, for otherwise all earnings attributable to cellophane would automatically be taxed at the excess-profits-tax rate.

Certain specific gross receipts and net income tests are provided, which are designed to preclude routine or ordinary business changes from the benefits of the relief section.

These tests are reasonable and they do separate the normal change from the substantial change. Because of its cellophane operation, Ecusta will meet each and every one of the requirements for substantiality. However, section 443 now provides that the change in product must have occurred prior to the end of the taxpayer's base period.

The end of our base period is December 31, 1949. But we did not actually commence the manufacture and sale of cellophane until June 1951. Bear in mind, however, that we commenced negotiations for the cellophane contract in October 1948.

By November of 1949 the contract with du Pont had been executed and arrangements for financing had been completed. These carefully laid plans obviously were in no way related to an inflated economy brought about by the Korean invasion, which occurred on June 28, 1950, 7 months after our commitments were made. At the time of the Korean invasion we had invested more than $5 million in the cellophane venture. It is therefore clear that the entire project was conceived and was well on its way to reality before many of us knew anything about a country known as Korea. It appears that this is an instance, and there may be others, where American business has sought out new fields, invested substantial funds providing new jobs for many people, and under the present excess-profits tax law all earnings resulting from these new ventures will be subjected to excess profits taxes in addition to the high normal and surtaxes.

Gentlemen, that is unfair. And I am sure it was not your intention deliberately to penalize industry for being industrious.

As I understand the theory of the excess-profits tax, its purpose is to siphon off corporate earnings which result from a stimulated demand from the war effort or directly from sales of manufactured articles to the various military services.

None of us who have had business experience during World War I and World War II would take exception to the theory of the excess-profits tax in wartime.

However, caution must be exercised to distinguish between normal profits and war profits. It is my opinion—and I am sure fair minds will agree—that any venture conceived, arranged, and to a large extent actually carried out prior to the event of war—in this case June 28, 1950—should be treated differently from those ventures which are brought about as a result of the war or which are made possible and feasible from a business point of view because of a stimulated demand or a level of prosperity which is directly attributable to the war. Under present law Ecusta will not qualify for relief under section 443.

The cellophane plant of Ecusta required an investment of many millions of dollars. Based upon the 1949 tax rate of 38 percent, the return on the total investment should have been approximately 15 percent.

Senator TAFT. You mean before or after taxes?

Mr. HANES. That should be before taxes.

Senator KERR. There would not be any difference before taxes?

Mr. HANES. I beg your pardon, Senator; that would be 15 percent after taxes.

Senator KERR. After taxes?

Mr. HANES. Fifteen percent after taxes; that is right.

These are the figures which were projected by the company when it decided to enter into a contract with du Pont and invest a substantial amount of money in an entirely new venture.

Under the House bill now before you, however, the tax rate on the estimated cellophane earnings before taxes will not be 38 percent but will be 82 percent, making the return on the investment slightly under 5 percent—and again that is after taxes—while a return of 16.7 percent for this type of operation is recognized as normal by the Excess Profits Tax Act.

Senator TAFT. What choice do you have today? You have a choice of—your base can be 16.7 percent before taxes, is that it, before the excess-profits tax applies?

Mr. HANES. Generally the way this operates in this case is about as follows: Practically all of the earnings of cellophane, superimposed upon the earnings of cigarette paper, will be taxable at the maximum rate of 82 percent, and even under the House bill——

Senator TAFT. That cannot quite be, because you get an additional—at least 12 percent return on the additional capital that went into the cellophane——

Mr. HANES. In calculating our case——

Senator TAFT. Twelve percent and, in fact, you get more probably because of the type of business, 16.7. Is that where that 16.7 comes in?

Mr. HANES. That is the normal recognized under the normal excess-profits tax base for this industry that is the normal rate of return.

Senator TAFT. Then you do get, on this new business before the excess-profits tax begins, 16.7 percent on the money you put into it, is that right?

Mr. HANES. It does not work that way in our case, Senator, and I will tell you why.

Senator TAFT. Why not?

Mr. HANES. This is a highly technical accounting question in this case, and I have with me here an expert accountant who will be glad to explain that to you. I am sorry I cannot explain it adequately because it is such a highly technical question.

Senator TAFT. Well, it does not affect the argument you make particularly. I only am trying to see how the present law operates and what kind of relief it does give in this kind of a case. I am only curious to find that out.

Mr. HANES. Well, in our case, Senator, it does not give us any relief whatsoever.

Senator TAFT. It must give you relief. I cannot see what the——

Mr. HANES. If you would like our accountant, I would be glad to have him explain that to you.

Senator KERR. Let us have the accountant come up here and tell us why.

Senator TAFT. Tell us why you do not get the 16.7, at least.

Mr. HANES. Mr. O'Connell, would you explain that?

Senator TAFT. You figure on net 15 percent after taxes, so 16.7 percent before taxes would not be very——

Senator HOEY. Give your name, please.

Mr. O'CONNELL. Walter F. O'Connell, certified public accountant, Greensboro, N. C.

The capital used to construct the cellophane plant was contributed by the parent corporation of Ecusta. That provided Ecusta with a capital addition, but produces a capital reduction in the same amount for the parent corporation so that there is no increase in the excess-profits credit for the group.

Senator TAFT. Do you file a consolidated return?

Mr. O'CONNELL. No; we do not.

Senator TAFT. Then, so far as the Ecusta is concerned, you could get the other 16 percent or 12 percent?

Mr. O'CONNELL. No; the capital was not contributed; the capital was advanced as a deferred liability.

Senator KERR. Well, with reference to the operator, is it not borrowed capital or is it not invested capital?

Mr. O'CONNELL. It is mostly accumulated earnings and some borrowed capital which was borrowed prior to the end of the base period.

Senator KERR. It could not be earned capital by this corporation if you formed a corporation to do this job, could it?

Mr. O'CONNELL. It was earned by the parent or by the sub.

Senator HOEY. If it is earned by the parent, you do not get credit for it.

Mr. O'CONNELL. That is correct.

Senator TAFT. Well, it is earned by the subsidiary. The earnings that you are referring to here that you are paying these taxes on are earned by the subsidiary.

Mr. O'CONNELL. That is correct.

Senator TAFT. What you are saying is that the subsidiary does not get any allowance for money that is borrowed, but he does get some allowance. How much does it get?

Mr. O'CONNELL. Seven hundred and eighty thousand dollars on a $6½ million capital contribution, and the parent corporation suffers a $780,000 capital reduction because it is an increase in inadmissible assets to the parent.

Senator KERR. I would like to have Mr. Stam's reaction to that because I think that under the law the least they could get was 75 percent borrowed capital as though it were invested capital.

Senator TAFT. What is the parent company? Is it a holding company or an operating company?

Mr. O'CONNELL. It is an operating company.

Senator HOEY. Mr. Stam, what do you say about that?

Mr. STAM. I will have to look into the facts; but, of course, under the set-up of the excess-profits tax, you get 12 percent for additions to capital; that is, equity capital.

Mr. O'CONNELL. Accumulated after a certain date.

Mr. STAM. That is right. And, of course, on borrowed capital you get 75 percent.

Mr. O'CONNELL. On additional borrowed capital.

Mr. STAM. Yes.

Mr. O'CONNELL. That is right.

Senator KERR. On any borrowed capital, is it not, Mr. Stam?

Mr. O'CONNELL. On any borrowed capital; that is quite right.

The point here is that the money invested in the cellophane plant which will comprise the total assets of the cellophane operation, which operation is a part of the chemical industry, which should be allowed 16.7 percent credit on the total assets. Not on the net investment. That, you can readily see, is considerably greater than the 9-percent allowance on borrowed capital minus the interest adjustment.

Senator TAFT. 16.7 percent? I do not mean you—is that allowed for a new corporation? It is, is it not?

Mr. O'CONNELL. In the chemical industry?

Senator TAFT. If this were a new chemical corporation going into the cellophane business, they get 16.7——

Mr. O'CONNELL. On the total assets?

Senator TAFT. Total assets.

Mr. O'CONNELL. Whether or not it was borrowed or invested.

Mr. STAM. That is the base-period industry rate.

Mr. O'CONNELL. And the base-period rate is the ratio of net income before taxes to total assets?

Mr. STAM. Total assets.

Mr. O'CONNELL. Not to invested capital. The ratio of industry income to net investment, capital investment, net worth of this industry would, of course, be substantially more than 16.7 percent.

Senator TAFT. It would seem to us that Ecusta gets something. It seems to me they get 9 percent on the invested capital. There is some allowance for a base period. They are not left without a base altogether. You say in some way that is reflected by a reduction in the base of the parent company?

Mr. O'CONNELL. Yes, sir.

Senator TAFT. Why?

Mr. O'CONNELL. Because the parent corporation——

Senator TAFT. You have the same money you had before, and they have a historical basis that they operate on, presumably. I do not see why it affects them.

Mr. O'CONNELL. The parent corporation contributed $6½ million net to this new corporation.

Senator KERR. In what form?

Mr. O'CONNELL. Contributed capital.

Senator KERR. Did it buy common stock, preferred stock, debentures; or did it loan it the money?

Mr. O'CONNELL. It bought common stock.

Senator TAFT. For the cellophane thing or before that?

Mr. O'CONNELL. It bought the stock of the cigarette-paper plant and then added additional capital to it, which increased its investment in the subsidiary.

An increase in an investment in the stock of another company is an increase in inadmissible assets which results in a capital reduction.

Senator TAFT. Capital reduction; but, of course, if they are operating on a historical basis it does not affect them at all, if they are operating on a basis of historical earnings.

Mr. O'CONNELL. Oh, yes; it does. Yes; it does. The average earnings of the parent company are computed, and a credit is determined, and 12 percent of any increase in inadmissible assets after the commencement of the excess-profits tax period is a reduction of the earnings credit as well as——

Senator TAFT. Is that so, Mr. Stam?

Mr. STAM. Yes.

Senator TAFT. How does that work?

Mr. STAM. You see, the parent is giving up something.

Mr. O'CONNELL. Has a reduction.

Mr. STAM. So that they have their capital reduced.

Mr. O'CONNELL. So, therefore, the picture at Ecusta gives us the base-period earnings of the cigarette-paper operation plus a $780,000 capital addition; at the same time the parent corporation has its earnings credit minus $780,000, so that when you look at the group you have the cigarette-paper base-period earnings and the parent company base-period earnings. Now we have a brand-new operation and no excess-profits credit whatsoever. Also in this instance, because of the substantial credit allowed for cigarette paper, the cellophane profits added to regular income would not bring into play the over-all limitation. We will fall just beneath the over-all limitation so that every dollar of profit from our cellophane operation will be taxed at 82 percent.

Senator TAFT. Assume that you make the same money on the cigarette paper that you made before you gave up the foreign trade.

Mr. O'CONNELL. It would be substantially the same.

Mr. HANES. We have increased, Senator—I think it is fair to say it is not all cigarette paper. We have been manufacturing other types of paper.

Senator TAFT. What remedies do you propose?

Senator KERR. Senator, before you go to that, I would like to see if we can get a picture because I am like you, I do not understand it.

Senator TAFT. My mind is a little hazy. Perhaps if we can see what the remedy is, then we can see what we can do. I do not see how we are going to meet the situation that you suggest.

Mr. O'CONNELL. Here is the remedy, Senator. This change in product—and it is a change in product under the law because it meets these necessary tests, that is, that more than 40 percent of the gross receipts will result from the new product, and the excess-profits net income will be more than 125 percent of the base-period average.

However, the change was not made by the end of the base period, and our point is that we legally bound ourselves to make this change although the change did not become a reality until June 1951. But it was not something which resulted from the war; it was something that we commenced negotiations on——

Senator TAFT. What you want to get the advantage of is what finally results when you get this——

Mr. O'CONNELL. To allow us to pull back this change which occurred in June 1951, as though it occurred in our base period, and to allow us 16.7 percent of the total assets operating for Ecusta on cellophane and cigarette paper, give up our cigarette-paper earnings and have an entirely new credit.

Senator HOEY. And you ask that the contract relation date back to that period?

Mr. O'CONNELL. Yes, sir. A very definite commitment was entered into in November 1949, negotiations for which commenced 13 months earlier.

Mr. HANES. Senator, may I go back just 1 minute in answer to your question as to what would give us relief in this specific case? What would give us relief would be changing the date to the Korean War, which would adequately serve us, instead of making——

Senator TAFT. I know that. I want to see what the relief was that it would give you. It writes you into a class of new companies, considered entirely new, that get a brand-new credit based on industry earnings; which industry earnings, by the way?

Mr. O'CONNELL. Chemical—it would be chemical.

Senator TAFT. Cellophane and paper both, they are different.

Mr. O'CONNELL. Cellophane, when we are in full production, will comprise more than 50 percent of the gross receipts of the changed company.

Senator TAFT. So you want to have that 16.7 applied to the paper business as well as the——

Mr. O'CONNELL. Incidentally, the paper business.

Senator TAFT. Are the earnings more than that now?

Mr. O'CONNELL. It is earning more than that.

Senator TAFT. You mean the base is more than——

Mr. O'CONNELL. The base-period rate is 18.1 for paper.

Mr. HANES. 18.1 in paper.

Senator TAFT. Is that what you use now or are you using historical?

Mr. O'CONNELL. We are using our actual average earnings.

Senator KERR. Which is 18 percent.

Senator TAFT. Which is 18 percent or more.

Mr. O'CONNELL. It is more than 18 percent; 18.1 percent is the average for paper and pulp products.

Senator KERR. Let us get back to the capital structure of the new company for a minute.

Mr. O'CONNELL. Yes.

Senator KERR. What is it?

Mr. O'CONNELL. Ecusta is capitalized as follows: They had a million dollars in common stock. That stock was acquired——

Senator KERR. That is all right; that is immaterial. Let us get the capital structure.

Mr. O'CONNELL. They have $6½ million in net contributed capital—these are round figures, except——

Senator KERR. I thought you said the parent company bought stock with that $6 million?

Mr. O'CONNELL. No, sir. The parent company bought the million dollars par value common stock.

Senator KERR. For how much?

Mr. O'CONNELL. For $18 million. Then it contributed an additional $6½ million net to Ecusta so that Ecusta's balance sheet looked as follows: $1 million common stock, $6½ million contributed capital, and earned surplus of approximately $7 million.

Senator KERR. Is this the company that——

Mr. O'CONNELL. This is Ecusta.

Senator KERR. Are you not talking about the company that is to make the cellophane?

Mr. O'CONNELL. Yes, sir; the $6½ million capital which was contributed by the parent is a capital addition and provides Ecusta with an increase in credit of $780,000; but the $6½ million having been contributed after December 31, 1949, causes a capital reduction as far as the parent is concerned.

Senator KERR. I understand but let us get away from the parent. Let us stay with the company that is engaged in the new business.

Mr. O'CONNELL. Right.

Senator KERR. There is not any way that I can see that you would be unable to reflect in your capital structure upon which your credit is figured every dollar that has been invested in this new company insofar as that identity is concerned——

Mr. O'CONNELL. Well, sir——

Senator KERR. Is that correct?

Mr. O'CONNELL. I do not believe it is, sir. The accumulated——

Senator KERR. Is that not right, Mr. Stam?

Mr. STAM. That is right.

Mr. O'CONNELL. Accumulated earnings, Mr. Stam?

Senator KERR. Well, they are not accumulated earnings of this new company. They have to be invested capital so far as it is concerned. If it has got money that it has not earned, it has either got it by the issuance of stock or by borrowing it or by stealing it.

Mr. O'CONNELL. It borrowed it from the parent.

Senator KERR. Then it is borrowed capital.

Mr. O'CONNELL. It does not qualify as borrowed capital.

Senator KERR. If they borrowed it. There is no way for it to be borrowed capital if they did not qualify it.

Mr. O'CONNELL. It does not qualify; it is not evidenced by a note.

Senator KERR. That does not make any difference. The note does not create the debt; it just evidences it.

Mr. HANES. Under the law it says, Senator, it does not qualify, and I think that is correct. It does not qualify, and if it does qualify——

Senator KERR. I know it was the purpose of this committee to recognize borrowed capital.

Mr. O'CONNELL. Well, Senator, it is true that to the extent that any of the advances from the parent to the subsidiary which originated as outside borrowed capital, would provide some credit for the parent corporation.

Senator KERR. It provides 75 percent of the credit it would provide if it had issued stock for it.

Mr. O'CONNELL. Right.

Senator KERR. Now, this committee tried to fix it so that it would be a hundred percent, but that was changed in the conference.

Mr. O'CONNELL. Right. But in addition to the credit allowed on any outside additional borrowed capital, if this change had been actually made by December 31, 1949, rather than when it was made—committed to before that time, and consummated after that time—this company would be allowed a credit, we have estimated, of about $4,500,000 instead of $3,000,000 as it is now allowed.

Senator KERR. But the point about it was, as I understood this witness, he said that as it was, this company had no credit and that every dollar it earned was subject to excess-profits tax.

Mr. HANES. It has not any earnings.

Mr. O'CONNELL. It has a credit, and the cellophane earnings will be taxed at 28 percent.

Mr. HANES. I think you misunderstood me, Senator, in this respect: I just said that the cellophane earnings added to the paper earnings—the cellophane earnings addition would be taxed.

Senator KERR. You are getting into another phase of it; let us stay with this.

Mr. HANES. All right.

Senator KERR. This company has to have a credit base, in the first place, consistent with its capital structure, and consistent with over-all limitation of 62 percent, or I want to know how it is that it does not have it.

Mr. O'CONNELL. Well, Senator, for one thing, $6 million of the accumulated earnings of this particular company——

Senator KERR. How can this company have any accumulated earnings if it just started to sell?

Mr. HANES. No; it is not a separate company. You are confused.

Senator KERR. You said it was a subsidiary.

Mr. HANES. The cellophane was not a separate company.

Senator KERR. You said it was a subsidiary.

Mr. O'CONNELL. It is a subsidiary, but was organized in 1939 and had accumulated earnings at the end of 1949 of approximately $7 million, all of which is invested in the cellophane plant.

Another $6½ million net was contributed by the parent corporation.

Senator KERR. It was not contributed; it was either loaned or they bought stock.

Mr. O'CONNELL. Well, they contributed it, having previously loaned it.

Senator KERR. Mr. Stam, if this company, when it went into this new venture, had accumulated earnings of $7 million, would that be a part of its invested capital?

Mr. STAM. It would get credit for that amount if it was invested.

Mr. HANES. But the parent company would have it subtracted.

Mr. STAM. But the parent company would have it subtracted.

Mr. HANES. It would have it subtracted.

Senator KERR. It was not the purpose of the committee to have more than one credit.

Mr. HANES. In this case on the cellophane earnings we get no benefit at all from the additional earnings under this excess-profits-tax credit.

I think where you are being confused, Senator, if I may say so——

Senator KERR. I can tell you that you are going to have a big job on your hands if you are going to accurately delineate my own confusion. I would like for you to do that.

Mr. HANES. Maybe I can assist. I will try.

Senator KERR. Have you got this clearly over there?

Mr. HANES. No; and it is a confusing thing; that is the reason I have an accountant here. I am not an accountant, as you can plainly see.

I think, though, where we are off base here for a moment is that the Ecusta Paper Corp. is a subsidiary, as I said, at the first line of my statement, of Olin Industries, a wholly owned subsidiary of Olin Industries.

Now, Ecusta Paper Co. is a separate corporation organized under the laws of North Carolina.

The Ecusta Paper Corp., through its own accumulated earnings, through accumulated earnings of its parent, that is, Olin, and through borrowed money——

Senator KERR. Let us get back there, because you cannot say you did something through the accumulated earnings of its parent, because for it to do that that money had to change its identity from accumulated earnings of the parent to the loan money or borrowed money or invested money.

Mr. O'CONNELL. Invested money.

Mr. HANES. Just let us call it dollars, that is all right with me. That is fine.

Let us just say that the parent company and the subsidiary had a certain number of dollars.

They did not have enough dollars to build the cellophane plant, Ecusta dollars; which necessitated our borrowing the money from the Prudential Life Insurance Co.

Now, that subsidiary, Ecusta, owns both the cigarette-paper manufacturing and the cellophane manufacturing; it is not a separate corporation.

The cellophane is not a separate corporation; the cellophane is a part of Ecusta.

Senator KERR. All right.

Senator TAFT. Do you mean to say that this 6 million that Olin Industries gave Ecusta was borrowed from the insurance company?

Mr. HANES. No; I said that they got it from three sources. They got it from their own earnings, from their own cash assets, their own dollars.

Senator TAFT. Yes.

Mr. HAYNES. From Ecusta, from Olin, from the insurance company, and they were the dollars.

Senator TAFT. Did the insurance company loan directly to Ecusta, or the parent company?

Mr. HANES. To the parent company.

Senator TAFT. Then this parent company would not suffer this loss of 9 percent of the money they gave to Ecusta because they deduct from it what they got from—if they go out to borrow the money from the insurance company, they would not have a deduction in their base.

Mr. O'CONNELL. No, Senator; having borrowed the money from an outside source and being allowed the 12 percent, additional credit to the extent of 75 percent, despite that, had this change in product been a reality by December 31, 1949, we would have been allowed 16.7 percent, not 9 percent.

Senator TAFT. That is another question.

This thing started out with a claim that this 9 percent was entirely nullified by what the parent company had to give up, and I am suggesting that is not so if the parent company borrowed the money from the life insurance company.

Mr. HANES. Well, Senator, again as a——

Senator TAFT. They do not have a corresponding loss as against Ecusta.

Mr. O'CONNELL. Senator, to the extent that they contributed capital, they did have an offsetting loss in credit, is that not correct, Mr. Stam? Could not they balance against it the money they had to borrow in order to contribute the capital?

Mr. STAM. I think so.

Senator TAFT. I should think so. It means it is only—if you had had unused assets that you have now disposed of, but in this case you went out and borrowed the money to give Ecusta the $6 million.

Senator KERR. I think the question before us is different from what I first thought it was. When I first started here, I got the impression that they were a company without a base. As I now see it, they are a company with a 9-percent base, with reference to certain capital, instead of the 16 percent plus base with reference to all of its capital. I think that is the situation.

Senator TAFT. And a 20-percent base as to half of it.

Senator KERR. That is right.

Senator TAFT. That is in the paper business, and about a 9-percent base on what it got from the other, and you would be better off with 16.7 for everything.

Senator MILLIKIN. Mr. Chairman, I do not think that we can ransack the whole field of accounting theory at this hearing. I would like to find out briefly and succinctly what you are trying to do and why.

Mr. HANES. Well, Senator, the main purpose—the burden of my whole statement—narrows down to how to correct, and how to correct it is a very simple proposition in our case, and——

Senator MILLIKIN. Let me ask you this: Are you trying to get out of the category of a new company?

Mr. HANES. No; we are trying to get out of——

Senator MILLIKIN. What are you trying to get out of?

Mr. HANES. Senator, we want the date for determining whether or not the change in product or service was affected, we want that date extended to cover the period that it took us to get into the manufacture of cellophane.

Senator MILLIKIN. You are trying to get a more advantageous earning base?

Mr. HANES. Yes.

Senator MILLIKIN. Is that correct? That is the whole thing. Let us get that pegged, and let us not confuse that.

Mr. HANES. That is right.

Senator MILLIKIN. Now, on what theory do you want that base bettered?

Mr. HANES. For the purpose of determining whether or not a change in the products or services has been effected. Any substantial change which the taxpayer had made or was legally committed to make prior to June 30, 1950, shall be deemed to have been made prior to the last day of its base period.

Senator MILLIKIN. In other words, the legal commitment as——

Mr. HANES. That would solve our problem.

Senator MILLIKIN. Shall take the place of an actual operating base, is that correct?

Mr. HANES. That is correct.

Senator MILLIKIN. Under the circumstances that you have revealed here?

Mr. HANES. That is correct.

Senator TAFT. But the statement which I questioned is in your statement, and that is what I cannot understand now. You say, "Under the House bill before you now the tax rate on the estimated cellophane earnings before taxes would not be 38 percent but 82 percent, making the return on investment slightly under 5 percent." That is the thing that I think you would have difficulty in proving. That is the only question that I was raising in all of this discussion.

Mr. O'CONNELL. To the extent, Senator, that money borrowed from the life insurance company was used in the construction of the cellophane plant, which is by no means the entire cellophane investment—the accumulated earnings of Ecusta were about $7 million and there was a net capital contribution, not an advance, not a loan, of $6½ million.

We estimate the total cellophane cost with working capital would be $20 million.

Senator TAFT. I wonder if you would just, for my information, write me a letter explaining this sentence, how you support that.

Mr. O'CONNELL. I would be glad to.

Senator TAFT. All right.

Mr. HANES. I think, Senator, that if I may be allowed to insert in the record a more complete statement—I have one with me—I was trying to save time and get over a lot of these details, but I would like to give you and I will send to each member of the committee, and we will supplement it, Senator Taft, with a letter to each member of the committee, explaining and proving this statement, because I believe what I stated was an absolutely true fact, and we can support it, and if you will give us that opportunity, I am certain we can do it.

Senator HOEY. You may insert it in the record.

(The document referred to follows:)

ECUSTA PAPER CORP.,
Pisgah Forest, N. C., July 27, 1951.

Hon. ROBERT A. TAFT,
United States Senate, Washington, D. C.

MY DEAR SENATOR: I enclose herewith a letter addressed to you by our tax adviser, Walter F. O'Connell, and signed by him.

This letter comes to you in response to a statement made by you during my testimony before the Senate Finance Committee on July 26 to the effect that you did not see how it was possible that our cellophane earnings could be taxed at 82 percent.

I asked for and was granted the privilege of submitting a letter in explanation for the record. I sincerely hope this letter, Walter O'Connell's letter and my supplementary statement can be inserted in the record at the end of my testimony. This is highly desirable because I fear that there was some confusion left in the record on this point.

If Mr. O'Connell's letter and the brief do not completely answer all of your questions, I hope you will afford us the opportunity of discussing this matter further with you.

With kindest regards,

Faithfully yours,

JOHN W. HANES.

W. F. O'CONNELL & CO.,
Greensboro, N. C., July 27, 1951.

Hon. ROBERT A. TAFT,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: In the course of a statement made before the Senate Finance Committee on July 26, 1951, by John W. Hanes, president of Ecusta Paper Corp., Pisgah Forest, N. C., he stated as follows:

"Under the House bill now before you, however, the tax rate on the estimated cellophane earnings before taxes will not be 38 percent but will be 82 percent, making the return on the investment slightly under 5 percent, while a return of 16.7 percent for this type of operation is recognized as normal by the excess-profits-tax law."

You asked for an explanation of this statement. Because of the complexities of the facts and law involved and the shortness of time we were unable to satisfactorily explain it to you. You then requested that I write you a letter supporting the statement.

The excess-profits credit of Ecusta Paper Corp. is determined on the earnings basis. It is made up of 85 percent of its average base-period earnings (all from the cigarette paper operations) and 12 percent of a net capital addition of approximately $6½ million representing a net capital contribution from its parent.

In November 1949 Olin Industries, Inc., borrowed $20 million from Prudential Insurance Co. the proceeds of which were used to buy all of the Ecusta stock for $18 million. At that point under present law Olin suffered a loss in excess-profits credit because 75 percent of the $20 million loan less 75 percent of the interest adjustment is exceeded by the increase in inadmissible assets of $18 million.

The Ecusta cellophane plant was financed from—

(1) Funds representing prior years Ecusta profits.

(2) Funds representing prior years parent company profits which were:

(a) Contributed to the capital account of Ecusta in 1950, and

(b) Advanced on open deferred account to Ecusta during 1950 and 1951

The funds under item (1) in no way affect the excess profits credit of either company.

The funds under 2 (a) constitute a net capital addition to Ecusta since the contribution occurred after January 1, 1950. This net capital contribution approximated $6,500,000 and increased the Ecusta Co. credit by 12 percent thereof or $780,000. At the same time the contribution increased the inadmissible assets of the parent causing a capital reduction in the same amount so that excess-profits credit is simply switched from the parent to Ecusta. There is no increase in excess-profits credit for the group.

The funds advanced under 2 (b) do not qualify as borrowed capital of Ecusta as they are not evidenced by notes. If they were evidenced by notes they would qualify as borrowed capital of Ecusta but would constitute a capital reduction of the parent company in the same amount.

If the advances were converted into contributions to capital the effect would be the same as under 2 (a) above.

Since our credits were not increased in the aggregate by our investment in cellophane, all cellophane profits will be taxed at 82 percent.

In other words, Senator, our situation is similar to that of a single established company which invested its own funds (not new outside capital or outside loans) in a new product or an expansion. In such a case no additional excess-profits credit is allowed except under the relief sections (if it qualifies) so that all earnings of the new operation are taxed at 82 percent.

I trust that the above information together with the supplemental brief being submitted will satisfactorily answer your question.

Respectfully submitted,

W. F. O'CONNELL

SUPPLEMENTAL STATEMENT OF JOHN W. HANES, PRESIDENT OF ECUSTA PAPER CORP.

Ecusta Paper Corp. was organized in 1938 under the laws of the State of North Carolina and commenced the manufacture of cigarette paper from American raw materials in 1939. It has continuously manufactured cigarette paper until June of 1951 when it also commenced the manufacture of cellophane film under a license arrangement with E. I. du Pont de Nemours Co. When the volume of cigarette paper production declined in the middle of the year 1949 its then chief stockholders, Harry H. Straus, president of the company and John W. Hanes, director of the company, sought some means whereby employment could be found for those put out of work by the decline in production.

Olin Industries, Inc., has for many years been engaged in the manufacture of explosives, small arms and small arms ammunition. For many years commencing as early as 1929 Olin has expended substantial funds in research work in the cellulose field. During all of this time Olin was planning the manufacture of cellophane film under their own or other American or foreign patents. This cellulose development program culminated in negotiations with du Pont which commenced in October 1948. For the year following Olin and du Pont were in constant negotiation seeking an arrangement whereby Olin would be allowed to manufacture and sell cellophane under the du Pont patents. On November 4, 1949, Olin entered into a legally binding contract whereby it was granted the privilege of manufacturing and selling cellophane under the du Pont patents and du Pont agreed to construct for Olin an eight casting machine cellophane plant. Almost simultaneously, to be exact on November 28, 1949, Olin acquired from Straus and Hanes all of the stock of Ecusta and immediately commenced working out the mechanical details for the transfer of its license to Ecusta and the construction of the cellophane plant adjacent to the Ecusta cigarette paper plant in Pisgah Forest, N. C.

The Ecusta stock was acquired by Olin for the sole purpose of constructing a cellophane plant adjacent to the Ecusta cigarette paper plant. Ecusta had available excess power, land, and water facilities. By making use of these excess facilities it was possible for the cellophane plant to get into production approximately 1 year earlier with construction cost savings of several million dollars. Accordingly on February 11, 1950, the contract with du Pont was amended to provide for nine machines and immediately thereafter on March 6, 1950, both contracts (dated November 4, 1949, and February 17, 1950) were assigned by Olin to Ecusta. Prior to the working out of the details, however, it was known by Olin and Ecusta that the cellophane plant would be located at Pisgah Forest, N. C., and preliminary drawings, surveys, etc. were under way at Pisgah Forest. Construction actually commenced on April 3, 1950, and by June 30, 1950, Ecusta had invested approximately $5 million in the construction of the cellophane plant.

The excess-profits credit of Ecusta Paper Corp. is determined on the earnings basis. It is made up of 85 percent of its average base period earnings (all from the cigarette paper operations) and 12 percent of a net capital addition of approximately $6½ million representing a net capital contribution from its parent.

In November 1949, Olin borrowed $20 million from Prudential Insurance Co. the proceeds of which were used to buy all of the Ecusta stock for $18 million. At that point under present law Olin suffered a loss in excess-profits credit because 75 percent of the $20 million loan less 75 percent of the interest adjustment is exceeded by the increase in inadmissible assets of $18 million.

The Ecusta cellophane plant was financed from:—

(1) Funds representing prior years Ecusta profits

(2) Funds representing prior years parent company profits which were—

(a) Contributed to the capital account of Ecusta in 1950, and

(b) Advanced on open deferred account to Ecusta during 1950 and 1951.

The funds under item (1) in no way effect the excess profits credit of either company.

The funds under 2 (a) constitute a net capital addition to Ecusta since the contribution occurred after January 1, 1950. This net capital contribution approximated $6,500,000 and increased the Ecusta Co. credit by 12 percent thereof or $780,000. At the same time the contribution increased the inadmissible assets of the parent causing a capital reduction in the same amount so that excess profits credit is simply switched from the parent to Ecusta. There is no increase in excess profits credit for the group.

The funds advanced under 2(b) do not qualify as borrowed capital of Ecusta as they are not evidenced by notes. If they were evidenced by notes they would qualify as borrowed capital of Ecusta but would constitute a capital reduction of the parent company in the same amount.

If the advances were converted into contributions to capital the effect would be the same as under 2(a) above.

Since our credits were not increased in the aggregate by our investment in cellophane, all cellophane profits will be taxed at 82 percent.

In other words, our situation is similar to that of a single established company which invested its own funds (not new outside capital or outside loans) in a new product or an expansion. In such a case no additional excess profits credit is allowed except under the relief sections (if it quaiifies) so that all earnings of the new operation are taxed at 82 percent.

Section 443 of the Excess Profits Tax Act of 1950 is designed to provide relief for taxpayers who have changed their products so that the statutory base period earnings are abnormally low for the determination of an excess profits credit based on earnings. Relief from this type of abnormality was recognized by Congress under the World War II Excess Profits Tax Act, wherein section 722 provided relief for companies which changed the character of its business by way of a change in product or in certain other ways. In that act after exhaustive hearings a provision was included in section 722 (b) (4) whereby: "any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, * * * shall be deemed to be a change on December 31, 1939, in the character of the business * * *".

Under section 443 of the Excess Profits Tax Act of 1950 three tests must be met by a taxpayer in order to establish its eligibility to relief. These are:

(1) the change must have been consummated within the taxpayer's base period

(2) more than 40 percent of its gross income or 33 percent of its net income for the qualifying year must be attributable to the new product

(3) as a result of the change in product the excess profits net income for the qualifying year must exceed 125 percent of the average base period net income.

The sales of Ecusta Paper Corp. are approximately $16 million per annum. The average base period excess profits net income of Ecusta was slightly in excess of $3 million. The estimated excess profits net income of Ecusta during the taxable years will also be in slightly excess of $3 million. It is estimated that the cellophane plant will increase sales by $20 million and increase excess profits net income by slightly more than $5 million. Thus, Ecusta has substantially changed its product through the addition of cellophane.

From the figures set out above it is immediately clear that tests (2) and (3) will be definitely met by Ecusta. However, while the change in product was planned by the parent corporation as early as 21 years ago and while negotiations culminating in the present cellophane operation commenced in October of 1948, this change in product was not a reality on December 31, 1949. As section 443 now reads Ecusta would be denied any relief whatsoever. It was recognized in the drafting of the World War II excess profits tax law relief sections that changes in the character of a business were the result of long and careful planning. It was there recognized that commitments made to change the character of a business prior to December 31, 1939, might well not have been actually carried out until a year or more after that date. Intelligent businessmen add products, increase capacity and make other changes after the most careful scientific, engineering, financial and business surveys. It is inconceivable that products which by happenstance added subsequent to December 31, 1949, would be denied relief when in many cases legally binding commitments and in some instances the actual facilities necessary for production might well have been in existence by December 31, 1949. It is easily seen that the resulting inequity severely penalizes taxwise the very companies which should be encouraged because of the contribution they thereby make to the general prosperity of the country. Furthermore, it places the manufacturer of the new product in a position where it might be impossible to compete with the established manufacturer who has been making the product throughout the base period and who (assuming equal business ability) had earned the average return on investment of the entire industry.

It is recognized that some limitation must be placed on the extension of time within which changes in character should be recognized for relief purposes. The most realistic date for such a limitation would be June 28, 1950—the date of the Korean invasion. The Korean War came about so suddenly that even the day prior to June 28, 1950, may be described for relief purposes as a perfectly normal business day. Certainly the first 6 months of the year 1950 were normal business months in that business was not affected in any way by a war or defense economy. Since it is the theory of the excess profits tax law to siphon off excessive profits resulting from war business or a stimulated general business demand caused by the war, any period unaffected by the war can be described as normal and any change in the character of a business occurring or committed for during such normal period should be classified as a normal business change and thus be allowed to qualify for relief.

The change is particularly important to companies established in one field who enter an entirely new field. In such a situation the over-all limitation would not ordinarily apply and all of the earnings of the new product would be taxed at the suggested confiscatory rate of 82 percent. In the case of Ecusta the change which became a reality in June 1951, was planned as early as October 1948 and its parent corporation was legally committed to make the change on November 4, 1949, while the legally binding contract was assigned to Ecusta on March 6, 1950. All of Ecusta's anticipated cellophane profits will be taxed at 82 percent for the reasons set out above and because based upon the best possible present estimates the over-all tax limitation of 70 percent will provide no relief whatsoever. This places Ecusta in a position where it is virtually impossible for it's cellophane operation to survive in a competitive market where its competitors were manufacturing cellophane throughout the entire base period and therefore enjoy a fair and normal excess profits credit. Of course, this is a condition under which a business cannot survive and forms the basis for the request for the change in section 443.

In view of the fact that the identical problem was carefully studied by Congress when drafting the World War II Excess Profits Tax Act and since the Treasury Department in the administration of that act has had vast experience in applying the section the amendment could be patterned very closely on the committment section of section 722 (b) (4). It is therefore suggested that section 443 (a) (1) be amended by adding the following sentence at the end thereof: "For the purpose of determining whether or not a change in the products or services has been effected, any substantial change which the taxpayer had made or was legally committed to make prior to June 30, 1950, shall be deemed to have been made prior to the last day of its base period."

Senator TAFT. You see, it is not only a question of—we passed an amendment to meet your particular situation, and it turns out that that takes care of you, but we did not hit the particular thing that creates this kind of an inequity, if that is so. I do not think it is so, and that is what I am interested in.

Mr. O'CONNELL. I will be glad to do that.

Senator HOEY. You may put it in the record and also send it to the Senators.

Senator TAFT. I think if you get rid of this double company, and just have one company, here is a company that has a surplus, invests that surplus of its own in a new business, and maybe that company should have the same rights you are asking for, but under the present situation as I see it, they get no credit for the additional money because they had it already and the situation you are now striking at may not be at all fundamentally that it should be extended another year. Maybe we should solve the whole problem of new companies without this double corporate set-up that you have got. That is why I want to know just why this inequity occurs that you claim occurs under this sentence.

Mr. HANES. I believe you will find if you let us present this case to you by letter, that this amendment, the section of the law, the relief section now will effectvely stop corporations from expanding in new fields.

Now, I believe that that thing should be corrected, and I believe it is the will of this committee that it should be corrected.

Senator MILLIKIN. We have many facets of that same problem in the testimony here.

Mr. HANES. I am sure you do.

Senator MILLIKIN. I would like to suggest, of course, that you send the same letter to Mr. Stam——

Mr. HANES. Yes, sir.

Senator MILLIKIN. Because he will deal with the accounting practice that is involved.

Mr. HANES. Fine.

Senator MILLIKIN. And will be able to advise us on that, so that we do not have to take a course in accounting here.

Mr. HANES. That is right, sir. I assure you I will send to each member of the committee a copy, and I will send one directly to Mr. Stam.

Senator HOEY. Yes, sir.

Mr. HANES. Thank you, sir.

Senator HOEY. Thank you.

We were glad to have had you present.

North Carolina is a great producer and manufacturer of cigarettes, and we had to get all of our cigarette papers from France until Ecusta——

Senator TAFT. It also seems to be a producer of excess profits.

Senator HOEY. We are doing very well in that field but, of course, the industry in North Carolina and in the United States had to get all of the cigarette paper from France. Ecusta came into North Carolina and established a very magnificent plant, and it has been a remarkable success, and it is expanding into other fields.

We were glad to have Mr. Hanes and the other gentleman present.

Senator KERR. I would like to join the chairman in the remarks he made, and say to him that my effort in the matter was to get myself to where I could understand the problem, because I have never been of much value in solving a problem until I understood it.

Senator HOEY. I understand that fully. I am glad of the questioning. I think the letters will help clarify that.

Senator MARTIN. I think all of us want to encourage things of this kind.

Senator MILLIKIN. They have got the problem of bringing themselves under their own theory, and there has been so much confusion as to whether they have, and that, of course, leaves the question open and I do not think that we have a chance of solving that here.

The theory under which they proceed is perfectly simple. It is their burden to bring themselves under the theory.

Senator HOEY. Mr. William Cease, have a seat, please, and give your name and connection to the reporter.

STATEMENT OF WILLIAM W. CEASE, PRESIDENT, CEASE COMMISSARY SERVICE, INC.

Mr. CEASE. My name is William W. Cease, and I am president of the Cease Commissary Service, Inc., Dunkirk, N. Y.

Senator HOEY. All right, Mr. Cease; you may proceed.

Mr. CEASE. After the last gentleman who just appeared, I find myself not only confused but somewhat frightened.

I do not represent any large corporation that is able to borrow money from a parent corporation or even from the Equitable Life Insurance Co. I am a small-business man, and I am in the third largest retail business in this country. I run a restaurant, and we have to get our capital to expand from our earnings.

Senator MILLIKIN. What is your business?

Mr. CEASE. I provide food to workers in an industrial plant, and we are very happy—as a matter of fact, our goal is to make a 4 percent profit.

We do not have any capital structure as such, because the plants own the equipment within these factories, and they make the equipment available to us at no cost, and with no charge for utilities because it is the plant's desire that their workmen get food as cheaply as possible. That is the theory of it and that is the purpose of it, so that we do not have any capital structure as such to amount to anything on which you should seek any relief.

As I say here in my opening paragraph, I have become confused and frightened by our tax program and the effect it is having on the economy of our country.

I would like to amplify that by saying, "as it affects me and other little fellows like myself."

I was pretty well impressed that I was not to talk or take up over 10 minutes because you folks have got a lot of other important people to talk to, and I have prepared here a five-page memorandum, the reading time of which should be less than 10 minutes, and I am going to take a chance, the same as the gentlemen who preceded me, to waive that, and get just simply to the last page where I have these five points which I am trying to make.

Senator HOEY. The whole statement may be included in the record.

Mr. CEASE. I am very desirous that it will be, Senator Hoey.

Senator HOEY. Yes, sir.

Mr. CEASE. I request that it shall be.

Senator HOEY. That will be inserted in full.

Mr. CEASE. I am going to turn to the last page, and I will be very happy to answer any questions relative to these five points that you gentlemen see fit to question me about.

The first point that I am trying to make is that the ceiling on Federal income taxes should remain at 62 percent and not be increased.

My support of that is just the simple fact that we are finding it very dificult, if not impossible, to pay the 62 percent, and that is the sole basis of my recommendation that it should remain at 62 percent.

My second point is that the income credit should remain at 85 percent of base period earnings for those companies in a low income bracket, and that, too, sir, is based on my own experience, which I think reflects the experience of other small people such as myself.

Senator TAFT. I do not see why it does not apply to everybody, not only the small company.

Mr. CEASE. I am certainly not going to argue with you about that, Senator Taft.

Senator TAFT. It seems to me that it should apply to everybody.

Mr. CEASE. I am very happy to hear you say that.

My third point is that a company be allowed to adjust all its base period years and then exclude the lowest earning year.

I would like to amplify that a bit. The present law requires that you take your three highest years for your base period and then if you have any abnormalities, you adjust those 3 years, and I feel that this is not accomplishing what was intended, but just the reverse, because it could very well be that one of your lowest earning years would be due to strikes or abnormalities which this provision is supposed to help you eliminate.

In my own instance 1949 was one of our lowest earning years.

The Bell Aircraft Co., which is one of our major accounts, had a strike for approximately 4 months and we did not do any business. We had been planning for Bell Aircraft, and when we are forced to drop 1949 because it is a low earning year, we actually are forfeiting one of our best years if we adjusted it to the receipts that we would have taken in at that time had that plant not been closed down for 4 months.

I feel that all people should be permitted to adjust all of their years for abnormalities and then take the three best years.

Senator KERR. Can't you take any 3 years you want? You are not required to take the three highest, are you?

Mr. CEASE. Yes, sir; you are. May I ask this gentleman, Mr. Stam, who I believe is your expert?

Mr. STAM. You would take the three highest.

Senator KERR. But you are not required to.

Mr. CEASE. Yes, sir.

Mr. STAM. Yes, sir.

Mr. CEASE. And that is the point I think which is unfair.

Senator KERR. What you would like to do is to take any of the 3 years and adjust them in accordance with the formula of adjustment now in the law?

Mr. CEASE. That is in essence what I would like to accomplish, sir.

Senator KERR. All right.

Mr. CEASE. The fourth point that I would like to make is that the growth test in our experience and, I think it applies to little people and not to people who manufacture cellophane or television sets, that the growth test is too tough for a small, little business.

The growth test as it exists today gives you two alternatives:

(1) If your cash pay roll is increased 130 percent; (2) if your receipts have increased 150 percent. That 130 and 150 percent, to me, is a little confusing. It actually means, as I understand it, that you have to increase your payroll 30 percent or you have to increase your sales 50 percent, and we folks in the restaurant business, if we were to be able to increase our business a third in any one year, we would think we would be doing a grand job of increasing business.

We do not believe it normal growth to increase it 50 percent. The point that I am trying to make is that for corporations or companies in the relatively low income bracket, this growth test should be adjusted so that it is more equitable and more applicable to the actual conditions under which small business really works, and in my brief I recommend that the receipts test be reduced from 150 percent to 135 percent.

In other words, if we are smart enough to run our business and serve such good food that we increase our business a third, we are doing a darned good job, and to ask us to increase that business 50 percent is too tough. It is not reasonable, sir. Nor is it reasonable for the payroll test to be 130 percent. It should be 120 percent.

The fifth point—and I am trying to make five of them—deals with and is quite parallel to what the gentleman from the Ecusta Paper Co. is talking about.

We feel that a provision should be made to give relief to small companies with a heavy debt burden that was incurred during the base period. In other words, we understand that money must be raised to meet our Government's emergency program; we understand that, and we have no quarrel with it.

The Government has elected to say, "You must take 3 years out of that 4-year period for your base earnings," and then they say, 75 percent of it will be considered as normal earnings. On the remaining 25 percent, or the other quarter of your income, you pay an 82 percent tax. Gentlemen, if you borrow money to expand your business, you have to convince the bank that you are going to be able to pay it back, and the way you convince them that you are going to pay them back is to submit an earnings record, and then get your wife to sign the note or something, but you pay it back out of about a quarter of your profit.

In other words, to run a little business, you cannot very well plan to take more than a quarter of your earnings to pay off instalments on the new truck you bought or the new dishwasher you bought, and so forth. When one-quarter of these profits is going to be taxed 82 percent, you have only 18 percent left. Then you pay the State of New York—I operate in New York—4½ percent of this, and it does not leave you enough money to pay your indebtedness.

What I feel would be equitable, and particularly equitable to small corporations and small companies, was if you are going to take as a base of credit for excess-profits tax the earnings during a base period of years, that you should also take into consideration the liabilities that they incurred during those base period years.

Speaking for my own self and my own company, we planned an expansion back 5 years ago. We borrowed the money. We had no idea that this Korean situation was going to develop, or anything else. We borrowed the money and convinced the people that we were going to be able to pay it back out of our earnings.

Now, we are going to be unable to do so because one-quarter of our earnings are going to be subject to an excess-profits tax, according to the present program, of 82 percent. That is my statement; that is my story.

In my brief, I have requested, that corporations in the small brackets who incurred liabilities and established that they were going to start making payments in 1950 and future years, should at least be able to take the money that they have already promised somebody they are going to get that they be able to deduct this money before they start paying an excess-profits tax.

Senator HOEY. Thank you very much, Mr. Cease, for your appearance.

(The prepared statement of Mr. Cease follows:)

STATEMENT OF WILLIAM W. CEASE, PRESIDENT OF CEASE COMMISSARY SERVICE, INC., DUNKIRK, N. Y.

(1) As an average small-business man and an American citizen I have become confused and frightened by our Federal tax program and the effect it is having on the economy of our country.

(2) I have endeavored to analyze the proposed Revenue Act of 1951 as passed by the House of Representatives. Its proposal for tax increases makes it just about impossible for a small company such as ours to continue in business. I am referring to a company like ours which is owned privately by a few individuals and whose stock has no ready market. Our capital and credit, like those of thousands of other small corporations, are limited, and it is extremely difficult for us to acquire capital, whether by borrowing or by issuing equities, particularly in light of the proposed large tax increases. When, along with this overpowering tax burden, there is added the additional factors of credit curbs, price regulations, and other governmental controls, it is becoming increasingly difficult for a small operator to continue in business. Many may be forced to close shop. When the effect of these factors on our business multiplied by their effect on the thousands of other small corporations across the country is felt, the future of small business is not an optimistic one.

(3) Another difficult problem is the amount of cash that will be required during the first 6 months to pay 70 percent of our 1951 corporate taxes in quarterly installments of 35, 35, 15, and 15 percent in 1952. I am sure you will appreciate that earnings are not always represented by cash, but often, as in our case, it is represented by plant improvement, new equipment, inventory, and accounts receivable. In a small business such as ours, which has to meet obligations incurred during the base period years, for plant expansion and development, it is now and will be in the future well-nigh impossible to maintain both debt and tax payments. We simply will not have enough cash.

(4) There are so many features in the present tax laws, and in the proposed 1951 Revenue Act, particularly in regard to excess profits, which are inequitable to a small company, that I would like to call some of them to your attention, and to submit suggestions that will ease the huge tax burden on our class of corporation, and at the same time facilitate the Government collecting the necessary revenue required to meet the present emergency program.

(*a*) The over-all ceiling on normal tax, surtax, and excess-profits tax should certainly not be increased beyond 62 percent because this figure is already producing a crushing burden on small companies.

(*b*) Section 435 (e) of the Internal Revenue Code permits a corporation to use the so-called growth formula for computing its excess-profits tax credit if its payroll during the years 1948 and 1949 is 130 percent of its payroll during the years 1946 and 1947, or if its net sales during 1948 and 1949 are 150 percent of its net sales during 1946 and 1947. As it stands this relief provision for all practical purposes helps only the abnormal cases such as the television industry whose phenomenal growth is the marvel of this century. Average businesses just don't grow that fast—it takes longer for the ground work and expense of expansion to start paying off. The present tax law penalizes the average growing business by taking away the incentive to grow. Gentlemen, we as a Nation cannot afford to kill that incentive. As a practical proposition to help the average business, the payroll test should be reduced to 120 percent and the sales test to 135 percent.

(c) Section 435 (d) of the Internal Revenue Code states that in computing the average base period net income, only the net income of the three highest base-period years may be used as a basis. Before a corporation can adjust its base-period earnings to reflect abnormalities, it must eliminate the lowest base-period year. It seems to me that this treatment is exactly the opposite of what it should be, since the corporation's poorest year might be the result of the very abnormalities the effect of which it is intended to alleviate. In my opinion a small company should be allowed to use as its average base period the three best earning years after all adjustments.

(d) The excess-profits credit based on income should remain at 85 percent of average base-period net income, rather than be changed to the proposed 75 percent, if the average base-period net income is less than $100,000, so as not to penalize a small business confronted with the payment of a debt burden incurred prior to excess-profits tax years. With the proposed change, if a small business has earnings equivalent to its base-period average earnings, it will pay a tax of 82 percent on one-quarter of its earnings plus 52 percent on the other three-quarters of its earnings. If their current earnings are greater than the average base-period earnings they will pay an 82-percent tax on even more than one-quarter of all their earnings, plus 52 percent on the balance. This, gentlemen, leaves little out of which to pay the debt burden.

(e) Neither in the present nor in the proposed revenue act is there a tax-relief provision for small corporations who must retire by cash payment note issues, mortgages, and other long-term liabilities, incurred during the base period (January 1946 to June 1949, inclusive), where the maturity date on these obligations was determined prior to June 1949, requiring cash payments during 1950, 1951, and future years. As I have pointed out previously it is now and will be almost impossible for us to meet both our debt burden, which we incurred during the base-period years in order to expand our plant and production facilities, and the crushing tax burden.

We simply will not have enough cash. I propose, therefore, that the net income of corporations be exempt from excess-profits taxes on income used to pay long-term obligations to the extent of $50,000 in any one year, with $150,000 total exemption during a 5-year period (1950 to 1955, inclusive), or during the existence of the excess-profits tax, whichever is the shorter. The unused amount under $50,000 in any one year should be permitted to be carried forward to subsequent years in the 5-year period.

(5) To summarize I have endeavored to make these five points:

(1) That the ceiling on Federal income taxes should remain at 62 percent.

(2) That the income credit should remain at 85 percent of base period earnings for those companies in a low income-bracket.

(3) That a company be allowed to adjust all its base period years and then exclude the lowest earning year.

(4) That the growth test be reduced to 120 percent for payroll and 135 percent for sales.

(5) That provision should be made to provide relief for small companies with heavy debt burdens incurred during the base period.

The last point, gentlemen, I consider very important, as it seems both fair and wise that if the Government uses as a basis of credit on earned income an average income for a base period of years, it should also recognize the obligations of a small company to pay off indebtedness it incurred during those base period years, for the development and expansion of their business ,with the expectation of it being able to pay off this indebtedness from a higher income resulting from this expansion program, and provide for this in the Revenue Act.

(6) I appreciate your great interest in the problems of the existence and survival of small business in this country and I trust that you will see that consideration is given by your colleagues in the Senate to these tax problems which affect small business to a degree which calls for positive relief now if we are to remain in business.

Senator Hoey. There will be incorporated in the record a statement from Mr. Robert N. Miller, of the law firm of Miller & Chevalier, Washington, in lieu of his personal appearance, under date of July 24, 1951, and addressed to Senator George as chairman, along with his proposed amendment at the close of that statement.

(The letter referred to follows:)

MILLER & CHEVALIER,
Washington 5, July 24, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: One of my clients has requested me to call to the attention of your committee, a problem arising with respect to the excess profits tax, and to ask that it be considered in connection with the current revenue bill (H. R. 4473). The question is whether unused excess profits credit carry-overs and carry-backs survive statutory mergers and consolidations, and may be illustrated as follows:

In 1944, four affiliated companies ("the constituent companies"), so related by stock ownership as to qualify for filing consolidated income and excess profits tax returns in prior years, were merged into a fifth affiliated company ("the surviving corporation"), pursuant to sections 59 and 60 of the general corporation law of Delaware. Prior to the merger the constituent companies had paid excess profits taxes, but during that portion of 1944 following the merger and during the calendar year 1945 the surviving corporation had unused excess profits credits.

The Bureau of Internal Revenue will not allow such unused credits to be carried back with respect to taxable years prior to the date of the merger, apparently contending that the surviving corporation is not the same "taxpayer" as the constituent companies, and therefore not within the provisions of section 710 (c) (3) (A) of the Internal Revenue Code which allows such carry-backs and carry-overs to the "taxpayer."

This problem was passed upon by the Court of Appeals for the Second Circuit in *The Stanton Brewery, Inc.* v. *Commissioner* (176 F. 2d 573 (1949)). The court held that in a true statutory merger the surviving corporation was the same "taxpayer" as the constituent companies. While this case arose under the New York corporation law, the provisions of that law with respect to a statutory merger are substantially the same as those in the Delaware corporation law, and doubtless in the corporation laws of most other states.

Notwithstanding this decision of the Second Circuit, the current position of the Bureau of Internal Revenue apparently is that it will not permit any such unused credit to be carried back to constituent companies in any such merger. In taking this position, the Bureau seems to rely on *New Colonial Ice Co.* v. *Helvering* (292 U. S. 435 (1934)), although in that case there was no statutory merger. Rather, the new company issued stock to the old company in exchange for its assets and liabilities and the old company continued in existence for almost 2 years after the exchange, although transacting no business and having no income. The Supreme Court was apparently impressed by the fact that both the old and the new companies continued their separate existences after the exchange and this fact appears to be an important element in its decision.

In contrast to the factual situation involved in the Colonial Ice case, a statutory merger or consolidation under sections 59 and 60 of the Delaware corporation law, and probably under the corporation laws of most other States, results in a fusion of the corporate assets and liabilities. There is no separate transfer of title to the property from one corporation to another as in the transaction involved in the Colonial Ice case, or such as takes place in the liquidation of a subsidiary into a parent corporation. Rather, in a statutory merger the identities of the constituent companies are absorbed by the company surviving the merger, the constituent companies no longer have any separate existence and the surviving corporation acquires the assets and becomes bound by the liabilities of the constituent companies by operation of law. Ordinarily there is no change in the manner of carrying on the business and certainly no change from the standpoint of the customers and employees of the enterprise. Thus, there appears to be no logical reason why the unused excess-profits credit, which would have been the subject of appropriate carry-overs and carry-backs in the case of the constituent companies had the merger not occurred, should be denied simply because of their absorption by the surviving corporation. Also, the attitude of the Bureau of Internal Revenue on this matter seems inconsistent when compared with its attitude on excess pension contribution carry-overs, which it allows in the case of statutory mergers and consolidations (P. S. No. 62, dated May 5, 1950).

The enactment of the Excess Profits Tax Act of 1950 points up the importance of considering this problem of carry-overs and carry-backs in connection with statutory mergers.

Congress has recognized the desirability of allowing corporations to change their form of doing business by enacting the non-recognition provisions of the Internal Revenue Code. There is nothing in the provisions of the Code relating to carry-overs or carry-backs or in the legislative history which would indicate that Congress intended to penalize corporations which carried out a statutory merger. The effect of the Bureau's attitude, however, is to inflict a severe penalty, and to force the taxpayer to pay a substantial price taxwise for the greater efficiency of operating one corporation instead of several. We believe that Congress had no such intention and that this fact should be made clear by an amendment to the statute, retroactive to the enactment of the World War II excess-profits tax. If it is not, the Bureau will no doubt continue to adhere to the position which it unsuccessfully pressed in the Stanton case, resulting in considerable litigation in other circuits on the part of taxpayers who have carried out statutory mergers and consolidations not only under the old law but under the new law as well.

I am enclosing a draft of a proposal which we believe would solve this problem. If the substance of this proposal could be incorporated in H. R. 4473, it would serve to avoid litigation by clarifying an ambiguous situation in accordance with what we believe was the original intent of Congress.

We would appreciate it if you would make this letter a part of the record on H. R. 4473.

Respectfully,

ROBERT N. MILLER.

PROPOSED AMENDMENT

Effective with respect to taxable years ending after June 30, 1950, section 432 of the Excess Profits Tax Act of 1950 is hereby amended by adding thereto the following new subsection:

"(f) UNUSED EXCESS PROFITS CREDIT CARRY-BACK OR CARRY-OVER IN CASE OF A STATUTORY MERGER OR CONSOLIDATION.—In the case of a statutory merger or consolidation, the continuing corporation resulting from a merger or consolidation is the same 'taxpayer' within the meaning of that term as used in subparagraphs (1) and (2) of subsection (e) of this section as the merged or consolidated corporation or corporations."

SEC. 2. (a) Section 710 (c) of the Internal Revenue Code is hereby amended by adding thereto the following new subparagraph:

"(5) UNUSED EXCESS-PROFITS CREDIT CARRY-BACK OR CARRY-OVER IN CASE OF A STATUTORY MERGER OR CONSOLIDATION.—In the case of a statutory merger or consolidation, the continuing corporation resulting from a merger or consolidation is the same 'taxpayer' within the meaning of that term as used in subparagraphs (A) and (B) of subsection (c) (3) of this section as the merged or consolidated corporation or corporations."

(b) EFFECTIVE DATE.—The amendment made by this section shall be applicable to taxable years beginning after December 31, 1940.

(c) REFUNDS.—If refund or credit of any overpayment for any taxable year, to the extent resulting from the application of this section, is prevented on the date of the enactment of this Act or within one year from such date, by the operation of any law or rule of law (other than sec. 3761 of such code, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year from the date of the enactment of this Act.

Senator HOEY. Mr. Walter Truland. Give your name and connection to the reporter.

STATEMENT OF WALTER R. TRULAND, PRESIDENT, WALTER TRULAND CORP.

Mr. TRULAND. All right, sir. My name is Walter R. Truland, president of the Walter Truland Corp., of 1715 Lee Highway, Arlington, Va., and I am appearing in behalf of the governmental affairs committee of the National Electrical Contractors Association. This association has a membership of more than 3,100 electrical contractors throughout the United States and for 50 years it has been the representative of the electrical contracting industry which is responsible for the installation engineering of all types of electrical systems and equipment in factories, public buildings, defense establishments, commercial enterprises, and homes.

My purpose in being here is to call to the committee's attention the fact that in its first year of operation, the 1950 Federal excess profits tax law has shown itself to be a serious deterrent to the national-defense-production effort. It has resulted in such serious discrimination against a considerable segment of our industry as to demand immediate correction.

It is the experience of our industry that the excess profits tax law not only imposes serious inequities on our industry and upon individual companies within the industry but poses a definite threat to the efficient and expeditious execution of the defense-construction program. Furthermore, it tends to impair the freedom of opportunity the freedom of entry into the business of construction contracting.

Senator KERR. Are you boys who are already in it opposed to anything that will impair the freedom of others to get in there and compete with you?

Mr. TRULAND. Well, personally, the reason I have a personal interest in this is that our company was formed during the base period so we have no excess profits tax background. We must depend upon the industry-established percentages.

Senator KERR. I see.

Mr. TRULAND. This adverse effect results from the application of section 447 to the business of building construction. The most devastating effect of this law is on the newly-formed corporations and those organizations established or reorganized in the postwar period to handle the huge task of peacetime, and more recently, defense mobilization, building.

In accordance with that statute, the Bureau of Internal Revenue has established tentative base period yearly rates of return for various industries, including that of "Special trade contractors (contract construction)."

Electrical contractors apparently come within that classification and the tentative base period yearly rate of return for the base period, 1946–49, was published officially as 13.1 percent of invested capital.

Because the 13.1 percent determination did not appear to have any realistic relation to prevailing conditions in the industry, the National Electrical Contractors Association made a spot survey of contractor organizations of various sizes in all major geographical areas of the country. Object was to determine whether the tentative base period rate of return—the "normal" profit on invested capital—was in line with the 13.1 percent figure. This survey revealed such wide fluctuations such as to make us wonder on what basis the Treasury or whoever determined this 13.1 percent figure could have arrived at that figure or, in fact, any figure. We found that the rate of return ranged from 20 percent to 400 percent. Most of the returns were in the 30 to 80 percent bracket which suggests that perhaps 45 to 50 percent on invested capital for the electrical contracting industry would be a more logical and accurate finding.

The average profit (invested capital) for a large contractor in the Detroit industrial area that we surveyed for the 4-year base period was 86 percent. A contractor in the Ohio Valley industrial region reports an average return of 31 percent.

Senator TAFT. The truth is it has very little relation to the invested capital. It depends more on the personality of the people running the business than capital.

Mr. TRULAND. Yes, sir.

Senator TAFT. Is that not correct?

Mr. TRULAND. Yes, sir. That is the difficulty we find ourselves in.

Senator TAFT. The same thing was true about the automobile sales base yesterday.

Mr. TRULAND. Exactly. In exactly the same boat that they are.

Invested capital is important, it is relatively important to manufacturing industries and retail industries where you must have a store and have a lot of capital invested. That is the point we are planning to bring out here.

Among the others we surveyed was a contractor in the Rocky Mountain region who had an average rate of 64 percent. A southern contractor reports an average return in the base period of 87 percent. A Pacific coast contractor had an average return of 51 percent. A New York contractor reported an average profit of 22 percent, that is for the 4-year period.

From these typical reports from the survey it can readily be seen that the variation is too great to constitute any dependable and fair guide for the purpose of taxation.

Actually we feel that probably if the individual were given free rein for his ability sales would be the only fair method of determining what a fair profit would be.

The reason for this conclusion lies in a fundamental nature of the construction business. Unlike most other types of business, large amounts of capital are not required by the construction contractor to carry on even very large industrial building projects.

First, it is necessary that the circumstances and the conditions under which building construction is carried on be taken into account. Contract construction is something entirely unlike the conduct of a manufacturing or distributive operation conducted from a fixed location with more or less fixed and constant conditions. Our business is subject to wide variables of weather, duration of job, location, labor relations and supply, local regulation and many other factors.

Insofar as taxation is concerned, what we estimate to be anticipated profit today may, when the job is concluded 1, 2 or 3 years hence, well turn into a serious loss. What we might deem a fair estimate of profit for the current year may turn out to be much larger 1 or 2 years hence. Indeed, I find my company subject to excess-profits taxes on most of the business done months before Korea day.

The construction contractor is a combination of on-site manufacturing, and services, including highly skilled and trained professional services and management. The business is a terrific gamble. Those two conditions make unnecessary and, indeed, preclude the employment of any relatively large amounts of capital in the venture. The risks make substantial investment unattractive with the result that capital investment must, with very few exceptions, come from the profit structure of the organization. This tax makes the addition of capital for the business very difficult, and indeed, it makes it hard for us to accumulate the tools required for the efficient performances of our work.

Take the example of a recently-organized medium-sized electrical contracting firm with $200,000 in invested capital, and $50,000 would probably be a very high average. That is an above-normal figure of invested capital in the construction business. Assume that in the first 3 months of 1951 he made a profit of $25,000 which is approximately the "normal" rate of return allowed under the present regulation before excess profits are applied. Management has three options:

1. He continues to do business but if he makes any profit at all he would be able to keep not much more than 13 cents on every additional dollar earned.

That is, including State taxes.

2. He may stop working for the balance of the year.

3. He may seek ways to raise money and increase his invested capital base so that he may retain more of the profits earned.

Roughly, present corporate and excess-profits taxes take 77 percent of profits after the allowance for the "normal" rate of return of 13.1 percent in our industry. A 5 percent additional corporate tax increase is impending. State taxes siphon off 5 percent more, or a total of 87 percent of all income for this contractor after he makes $25,000. He may keep but 13 percent.

The risks and the wear and tear on management makes continuation of work under such incentive illogical. Logic indicates the alternative of stopping work. It so happens that electrical contractors are engaged in work of extremely vital importance to the defense and the civilian economy. If any large number of them retired for the remainder of the year, the result would be very serious. Neither myself nor any electrical contractor desires to "go fishing" for the rest of the year but we do hesitate to risk our business—which, indeed, we must risk every time we undertake an important contract, for the chance—if we are lucky—to make 13 cents on the dollar, and that is still in the corporation; we do not have our hands on it yet.

Application of the present law is definitely a deterrent to the entry of new firms into the contracting field. The hazards involved far outweigh the very narrowly limited profit possiblities. Thus, the excess-profits law strikes at the foundation of the Nation's asserted policy of free competitive enterprise with its cherished freedom of entry. The Bureau of Internal Revenue can effectively block free enterprise by discriminatory taxation to a greater degree than all of the schemes of monopolistic practice the Sherman and Clayton Acts attempt to prescribe.

It is our understanding that the excess-profit law's provisions would be observed by the Treasury and the Joint Committee on Internal Revenue Taxation during its first year and that corrections would be made then as deemed proper. We thank you for this opportunity to call attention to some basic points in the application of this law to the construction business.

We submit that this law, designed to siphon off excess war profits, is not doing that, but rather, is seriously impairing some important economic foundations to our defense effort. With the committee's permission, I would like to leave with you a more detailed analysis of the situation together with some suggestions for corrective amendments to section 447.

After we prepared this brief and the attendant one, we submitted it to the Mechanical Specialty Contracting Industries Liaison Committee. They represent the mechanical specialty contracting industries, the National Association of Master Plumbers, the Heating, Piping and Air Conditioning Contractors National Association, and after reviewing it, they have concurred in our opinion as regards that.

Now, in the aggregate we represent about 40 percent of the entire construction industry, doing some $5 billion worth of business a year, and having a quarter of a million skilled men working, and in that group, of course, there are about 10,000 heating contractors, 10,000 electrical contractors, and 25,000 thousand plumbing contractors.

We feel that it is a very serious matter. We certainly hope you will give it some serious consideration.

Senator HOEY. We will include the supplemental statement in the record.

Mr. TRULAND. Thank you.

Senator KERR. Does your supplemental statement include your recommended amendments?

Mr. TRULAND. It includes three recommended amendments which we feel if the Treasury followed, they would come up with a much higher figure than 13.1, and it would also take care of certain other conditions.

Senator HOEY. Thank you very much.

(The document referred to follows:)

SUPPLEMENTAL STATEMENT OF WALTER R. TRULAND OF THE NATIONAL ELECTRICAL CONTRACTORS ASSOCIATION

The application of section 447 of the 1950 Federal excess-profits-tax law has resulted in very serious discrimination against construction contractors, including electrical contractors, who have started in business immediately before or during the base period 1946–49 or since that time, or those who have suffered flood, fire, or other catastrophe or have had the misfortune to have business losses in the base period.

The law will not adversely affect many contractors for the reason that they were in business for a considerable period before the base period and enjoyed fairly good business and profit return during the 1946–49 period. But its effect on those not so fortunately situated is devastating and will, unless corrected promptly, force them to curtail their operations substantially or retire from business. Other than being grossly unfair to them, it would tend to keep their needed production facilities from making their contribution to defense mobilization.

An understanding of the nature of the construction contracting business is necessary to appreciate the serious effect of the arbitrary application of this tax to this industry. The industry operates subject to wide variations in duration of job, conditions, competitive conditions and fluctuations of costs. Major electrical work often involves a period of 2 or 3 years and what started out to be a good anticipated profit often ends up as a bad loss. In my own company we find ourselves subject to excess profits today on work actually undertaken and completed months before Korea, or before the enactment of this present law.

There is no determinable fair rate of return on a construction contract. The Bureau of Internal Revenue officially publishes a tentative base period rate of return for the electrical contracting industry as averaging 13.1 percent for the 1946–49 base period. This is based on the taxpayer's choice between equity invested capital (amount paid for capital stock, earned surplus and an addition for borrowed money), and historical invested capital.

NECA made a spot check of typical electrical contracting firms of various sizes representative of all geographical locations. This survey confirmed the conviction of those familiar with the business that construction contracting profits cannot realistically be related to invested capital. There are good and sound reasons for this.

One is that no large amount of capital is required to undertake and execute a construction job even of very large proportions. Very ew electrical contracting firms have invested capital of more than $150,000. The average is far below that. Those with invested capital exceeding $250,000 are rare. Yet these firms regularly and normally transact business to the extent of a million or more dollars a year. Research studies of the NECA Research Department develop the fact that it is not worth the risk and the management effort involved to perform this extremely specialized and technical operation at a profit of less than 20 percent on volume of business done. Very few achieve this happy objective, however. One reason for this is that since 1947 the electrical construction industry has been in a price war featuring below-cost bidding. It is perhaps true that of all construction contractors, electrical contractors do have the highest invested capital. Much of their capital is in tools, for good, modern tools and plenty of them are a necessity for the efficient and competitive operation of a highly-specialized electrical contracting operation.

Another consideration is that construction contracting is one of the riskiest of business ventures. No other business involves such major elements of gamble. Therefore, risk capital is not usually available. Rates of actual profit return and very high tax rates of recent years have made it difficult for a contractor to build up invested capital. Indeed, many find it difficult to provide themselves with adequate tools and equipment with which they can perform in an expeditious and economical manner.

The NECA spot check shows almost fantastic variations in profit relation to invested capital. Take my own company, formed October 1946. Naturally we had no base period. Our invested capital is low even though we have much larger than normal investments in tools. At the end of the first 6 months of 1951 we find that we have reached (or exceeded) the 13.1 percent rate of return on invested capital and face the prospect of having to pay taxes of 87 percent on every additional dollar of profit gained between now and December 31. That is a confiscatory tax. It effectively wipes out incentive. Indeed, it makes operation of such a business with its very large risks an act of folly. Prudence would dictate that I retire from operations for the balance of the year.

Relief in this instance would have to be in the form of a materially higher rate of return than the present 13.1 percent determination. The NECA survey indicates, if any conclusion can be drawn from the widely varying figures other than invested capital is not a realistic base to measure profits, that any normal profit finding on this base of less than 45 percent does not square with experience.

A midwestern contractor checked in the NECA survey did consistently an annual volume exceeding $2,000,000 in each of the four base period years. His profit was consistently uniform for these years. It happened that he had formed the business into a new corporation at the start of the base period and had very low invested capital. As the years progressed, he poured money into the invested capital structure, until on the final years of the base period he had five times as much invested as originally. The profit, related to invested capital ranged from 400 to 80 percent. Profit based on volume was fairly uniform at approximately 10 percent.

In summary, these are the areas where the excess-profit-tax law works against the interests of the individual contractor, the industry, and the public:

Industry.—The nature of the construction industry makes any attempt to apply any rate of return on invested capital lower than 45 percent unrealistic and not in accordance with the facts.

Company.—Application of the tentative rate established for the specialty contracting industries is highly discriminatory against newly formed companies or those formed just prior or during the base period (1946–49). They have no choice between equity invested capital and historical invested capital and thus are not allowed the opportunity of selecting an equitable base.

National defense.—Application of the present law tends to force relatively new companies to curtail or cease operations after accumulating the amount of profits permitted before the excess-profits provision is applied. This tends to slow down defense construction and possibly could have an adverse effect on the mobilization effort.

Freedom of entry.—The nature of the present law definitely restricts freedom of entry into the construction business because it limits possible return to a point inconsistent with the amounts necessary for the acquisition of capital and capital equipment. At a time when full mobilization of construction resources is necessary, we have a law that is working very definitely in the opposite direction and is, in fact, strongly monopolistic in tendency. As such it is contrary to our national policy of full competitive enterprise.

In an attempt to remove some of the discriminations from the newly formed construction contracting company, or one subjected to loss or catastrophe in the base period, the following amended language of section 447 is suggested:

"SEC. 447. INDUSTRY BASE PERIOD RATES OF RETURN.

"(a) BASE PERIOD YEARLY RATE OF RETURN.—The Secretary shall determine and proclaim for each industry classification in subsection (c) a rate of return (computed to the nearest thousandth) for each of the four years 1946 through 1949. The yearly rate of return for each industry classification shall be obtained by dividing the sum of the aggregate net income (computed without regard to the net operating loss deduction provided in sec. (s)) and the aggregate interest deduction shown on the income-tax returns filed by the corporations in such classification submitting balance sheets, by the aggregate total assets of such corporations as of the close of the taxable year for which such returns were filed. Such aggregate net income, interest deduction and total assets for each such year shall include the amounts reported on the income-tax returns for the calendar year and the amounts reported on returns for other taxable years the greater part of which falls in such calendar year. For the purpose of this subsection, returns which showed no net income shall be excluded by the Secretary in all computations required by this section. The determinations by the Secretary required under this section shall be made on the basis of returns of other corporations, computing all rates of return after giving effect to renegotiation of contracts.

"(b) BASE PERIOD RATE OF RETURN.—The Secretary shall determine and proclaim for each industry classification in subsection (c) a rate of return (computed to the nearest thousandth) for the four-year period 1946 through 1949. Such base-period rate of return for each industry classification shall be obtained by aggregating the net income and interest deduction (such amounts being determined as provided under subsection (a)) for each of the four years and dividing the total of the three highest years by the sum of the total assets (determined as provided under subsection (a)) for such three years.

"(c) INDUSTRY CLASSIFICATION.—For the purposes of this section, taxpayers shall be classified by industry in such manner as to group together all taxpayers whose principal source of revenue is from similar sources and shall be subclassified so as to group together those corporations with reasonable comparable volume of business and filing income-tax returns in the same collection district."

Senator HOEY. Mr. J. C. Griffin, treasurer, International Register Co.

STATEMENT OF J. C. GRIFFIN, TREASURER, INTERNATIONAL REGISTER CO.

Mr. GRIFFIN. My name is J. C. Griffin. I am treasurer of the International Register Co. at Chicago.

I represent a medium-sized organization that has been in existence since 1891. We happen to be one of those subject to the full impact of the ceiling of 62 percent under the present excess-profits law, or 70 percent if the House measure is adopted.

We will confine our discussion to three main subjects: (1) How a sound fiscal policy is affected by Federal taxes; (2) analysis of the House bill and why it does not contribute to a good fiscal policy, and (3) our suggestions for the new bill to be reported out of your committee.

(*a*) Fiscal policy: The greatest need for a sound fiscal policy is to control inflation. We consider inflation a far greater evil than higher taxes. Any tax program reported out of your committee should be designed to combat this primary evil before it gets completely out of hand. Inflation is not like a water faucet that can be turned on or off at will. Its control is the result of long-time tax, spending, and other policies which have a cumulative effect on our economy.

The control of inflation consists primarily of: (1) Reducing Federal spending; (2) sound credit controls; (3) encouragement of personal saving; (4) sound tax laws; and (5) long-range tax planning.

We must cut Government spending at least 6 billion before imposing any more taxes. There has been an attempt to cut Government spending but so far the cuts have fallen far below what is needed. We business executives are constantly being reminded that we should conserve manpower, cut unnecessary expenditures, keep down inventories, not buy beyond our requirements, and increase our operating efficiencies by agents of Uncle Sam and we agree that the advice is good and must be followed.

These sensible anti-inflation suggestions can only succeed, however, if the Federal Government itself takes the lead in putting them into practice. The Federal Government is the Nation's greatest consumer of goods and services. It is the largest employer of civilian manpower. The cost of running the Government is reflected in everything we buy.

Unfortunately, the Federal bureaucracy obviously does not want to play in the Nation's anti-inflation team.

Senator KERR. You understand that the jurisdiction of this committee is limited to the matter of taxation?

Mr. GRIFFIN. Yes, I understand. I want to make the point, that is all.

Senator KERR. I see.

Mr. GRIFFIN. Some of the stories of indiscriminate buying on the part of the Armed Forces seem almost too fantastic to believe. There has been an increase of 225,000 Government employees during the 4 months ended April 30, 1951. In fact, some Government agencies have openly admitted that they are "stockpiling" employees "against the needs of the future."

According to the Department of Labor index the cost of living has risen 84 percent since 1940. But the price of Federal Government, in terms of taxes imposed on the people, rose by well over 500 percent between fiscal years 1940 and 1950—before Korea. The present emergency has sent it soaring even higher.

The analysis prepared by your own distinguished committee member, Senator Harry F. Byrd, and printed in the Congressional Record, February 5, 1951, points the way to many savings that can be effected.

Federal spending can be cut by at least the 6 billion we have suggested and, we repeat, until this is accomplished your committee should adopt an attitude of no more tax raises until satisfactory cuts have been made in Government spending.

Another important contribution to inflation pressure is too much competition for available goods. Sound credit controls administered by the Federal Reserve Board has proven very effective in helping. We think there could be more encouragement on the part of the Government for personal savings. Another way that the available money can be siphoned off is by a sound taxing policy and that is where your committee comes into the picture.

To appraise the impact of taxes as they affect inflation you must take into account that the effect of income taxes on any business enterprise is entirely different than on an individual subject to withholding taxes.

The business enterprise, whether it be corporation, partnership, or individual, has the money available and can use its judgment whether it wants to spend more or keep the money and pay taxes.

When a business reaches the point where a high tax rate takes effect, the tendency is for them to relax on their expense controls. In fact, it is becoming a sign of good management for a business to spend more money for certain types of expenses which can be charged off after they have reached their high tax bracket. Such spending causes a further demand for goods which, in turn, causes inflation.

On the other hand, an individual has his taxes withheld from his wages. He has no option as he does not have the money which he can spend.

Whether we like it or not income taxes on individuals on a fixed income subject to withholding taxes are noninflationary while taxes on business when they are too high become inflationary and can reach the point of diminishing returns.

The far too prevalent idea of soak the corporations and the rich many times reacts to the detriment of the workingman you are trying to protect. To provide more jobs and create new business and thus raise the living standards of all our citizens, a certain part of the profits of industry must be plowed back into new facilities. When the over-all tax paid by a business is raised too high, it acts as a deterrent to expansion. High taxes also will keep new enterprises from starting up that would otherwise provide new jobs for the workingman. In other words the old adage, "Don't kill the goose that lays the golden egg," certainly applies to our tax structure.

Too much emphasis is now placed on obtaining revenue from income. More revenue should be obtained from so-called consumption or excise taxes which are noninflationary. To illustrate the advisability of such changes in our tax structure, just picture in your mind a prolonged recession or depression. With our present tax structure the Government revenues would fall far below the actual fixed expenses of the Government which would be disastrous with our present debt. On the other hand, if more emphasis is placed on consumption taxes, the revenue would be there even though it might be smaller due to decreased buying. There will not be too much impact on the lower-income brackets if such taxes are not put on food and food products. In our opinion the lower-income group would be far better off by paying these taxes than they would be if unsound fiscal policies promote further inflation.

In this connection, we would like to make the observation that price controls are not a cure for inflation and cannot be relied on to keep prices down indefinitely. Regardless of your ideas on price and wage controls you should view such controls objectively.

Senator KERR. Did you think the control bill was before this committee?

Mr. GRIFFIN. No, sir; I knew it was not.

We believe that controls are like damming a river. By building a large dam you can hold back the water for a while but unless the flow of water is controlled the reservoir back of the dam will become full and then the dam will have no effect on the flow of the river. Similarly, controls will help to hold back inflation but change in fundamental conditions alone will cure it. It is interesting to observe that business is being asked by OPS to roll back its prices. If the Federal Government would roll back the over-all cost of its nonmilitary activities to their 1948 level—which the Hoover Commission and others said was plenty high—it would deflate the price of Government about $4,000,000,000.

There is also a great need for a long-range tax planning. Such planning has been totally lacking. If private business was run on a similar month-to-month planning the enterprise would be doomed to positive failure. The Budget Bureau should be required to project their budget over at least 2 years so tax burdens can be determined far enough enough in advance to permit a tax bill to operate at least 1 year before it is amended.

(*b*) *Analysis of the House bill:* We have carefully studied the tax bill which has passed the House. In our opinion, the act further aggravates the serious imbalance which has developed in the Federal tax structure during the past 12 years.

We were against the passage of an excess-profits tax last fall; not because of the higher taxes it made us pay but because no way has yet been found to administer an excess-profits tax with fairness to all taxpayers. This act is so discriminatory and distributes the tax burden so unfairly that it should be repealed and replaced with a defense tax of a straight percentage of total earnings to compensate for the loss of revenue from its repeal.

To impartially appraise the House bill you must consider both what the bill does and what it fails to do. Before exploring these points we want to state clearly that we favor imposing whatever taxes are necessary to balance the budget but only after an adequate cut in Federal spending.

We think the bill is bad for the following reasons:

(1) It imposes very high excise taxes on some items which are likely to cause diminishing returns rather than larger revenues. We advocate a general excise tax on all items except food and the scaling down of excise tax on so-called luxuries to a more reasonable tax level.

(2) It raises individual taxes by 12½ percent. The original proposal of three percentage points increase will do far more to control inflation.

(3) The proposed increase in corporation normal and surtax rates to 52 percent is too high and should be limited to 50 percent.

(4) The proposed change in the excess-profits tax will only further aggravate an already bad situation brought about by the adoption of the excess-profits tax last fall.

(5) The retroactive provision on corporation taxes is not in accordance with our principles of fair play. It has become impossible for business to plan their financial policies when their plans are constantly upset by hidden tax liabilities. The Senate has traditionally opposed this principle and we hope it will continue to do so.

(6) The proposal to increase the over-all ceiling on all forms of corporation taxes from the present 62 percent to 70 percent is in our opinion the most objectionable provision in the entire bill and will do more to increase inflation pressure than any other provision. By all standards this over-all limitation should not be increased at this time.

In general, the House bill is unsound and risky. Taxes that are too high will destroy the incentive for individuals and corporations to earn more and to further expand their facilities at a time when we badly need more production. Its provisions are for the most part more inflationary than is safe for the economy. I leaves the Treasury's revenues too much at the mercy of fluctuations in the business cycle. Worse yet it contributes to a tendency to promote socialism through taxation which in our opinion is the most dangerous trend in our tax structure.

(c) The new bill: We recommend that no new tax bill be reported from your committee until a substantial cut has been made in Federal spending and your committee has had time to change the many objectionable features in the House bill.

We believe that the new bill should produce enough revenue to assure a balanced budget after deducting the savings in the budget. The over-all savings in the fiscal budget is what I refer to. We summarize below what we think the new bill should include.

1. Over-all limitation of 62 percent for corporation taxes.

2. Any increase voted for corporations be made effective the same time that is used for individuals. This should not be earlier than October 1, 1951.

3. Corporation normal tax and surtax be limited to 50 percent.

4. Individual taxes be increased by three percentage points instead of 12½ percent.

5. The excess-profits tax be repealed and replaced with a defense tax. If this is not done the present law should be left as it is.

6. Adopt a general excise tax on all commodities except foods and food products to produce a substantial part of the needed new revenue.

I thank you for the chance to present our views.

Senator HOEY. Thank you very much, Mr. Griffin.

Mr. F. G. Chambers.

Please have a seat.

STATEMENT OF FRANK G. CHAMBERS, TREASURER, MAGNA ENGINEERING CORP.

Mr. CHAMBERS. My name is Frank G. Chambers. My home and place of business are San Francisco, Calif. I am the treasurer of the Magna Engineering Corp. of that city.

Let me first thank the committee for the opportunity of appearing here. I know you have a long and difficult task and I shall take only a few minutes to present a common problem which must face thousands of young taxpayers in similar circumstances.

I wish to call your attention not so much to a case of a hardship under the excess-profits tax law, but rather an inequity in classification which I do not believe you gentlemen intended.

I refer to a result of the law which has the effect of classing all new growing businesses begun in the postwar period with companies whose earnings are abnormally high because of the impact of the Korean situation. Far from being helped by war conditions, our business has been substantially pinched by shortages of critical materials. Even with that impediment, however, we are proud to be part of a typical American success story which is traditionally part of our American way of life, but which we believe cannot be repeated unless the law is modified.

After my release from the Army in 1946, my brother, an investor-engineer, and I gambled our entire time, efforts, and savings on the soundness of an idea for a new multipurpose home workshop machine which we named the Shopsmith. We incorporated in August and made our first shipments November 17 of 1947.

The traditional Horatio Alger combination of risking our limited savings and a lot of hard work in a completely new business predicated on a new idea began to pay off. We actually started with $10,000 and a $20,000 loan. In 1947 with only 6 weeks of actual operation, our sales were $172,000.

Senator KERR. What is your business?

Mr. CHAMBERS. I beg your pardon, sir?

Senator KERR. What is your business?

Mr. CHAMBERS. We make a tool called the Shopsmith which is a woodworking tool which home craftsmen use in their basements.

Senator KERR. For what purpose?

Mr. CHAMBERS. It is a saw, a lathe, a sander, a drill press, a horizontal drilling machine, and a jigsaw.

Senator KERR. For the making of furniture?

Mr. CHAMBERS. Making of furniture or for men who are home craftsmen who like to panel their basements, who build boats, and who do anything in wood.

Senator KERR. Men or women?

Mr. CHAMBERS. Well, 95 percent of our customers are men.

(Discussion was continued off the record.)

Mr. CHAMBERS. In 1948 our sales were $3 million. In 1949 they rose to over $3,500,000, and in 1950 to over $5 million.

I might add that had it not been for Korea our sales would have approached $6 million.

Under the provisions of the existing law we find ourselves facing taxes which may be as high as 62 percent, possibly to be raised to 70 percent, and we are thus classed with businesses whose profits are swollen either directly or indirectly as a result of war conditions.

Gentlemen, we simply cannot exist, much less grow, under the impact of that type of taxation, for book profits to an expanding enterprise are never represented by cash dollars in the bank, but in inventories, plant, tooling, and receivables. We have never felt we were in a position to even consider paying a dividend.

I wish to emphasize that I am not appearing here to ask any special favor or preferential treatment. I sincerely believe that I am stating the case of young business. We are not even eligible for the benefits of the so-called growth formula because we were not in business on January 1, 1946.

My own reason for not being in business, as I stated, on that date must be typical of a multitude of new businesses.

I was an Army officer on General Somervell's staff.

The thought is inescapable that this law, providing relief as it does only for companies formed prior to January 1, 1946, is a direct blow at the veteran who survived the war in the hope of going home and starting a business. The great majority of releases from the military services did not take place until early in 1946, as you all know.

Few of us could foresee that a law would be passed 4 years later which would legislate ex post facto against our chances of developing and holding a successful business. We were soldiering in 1945 when, according to EPT, we should have been incorporating.

I do not believe that Congress intended the consequences of the arbitrary January 1, 1946, date line. I appreciate the fact that some base period experience is necessary in order reasonably to determine whether a company is undergoing normal growth, and I do not presume today to tell this committee what the minimum base period should be. Some growth companies with a fiscal year ending June 30 may use the base period July 1, 1949, to July 1, 1950, as their base period for excess profits tax purposes, so it is obvious that a short base period is possible.

But companies not formed before 1946 are not eligible to use even this 1-year period. It should not be too difficult to identify companies similar to our own which are founded - many by veterans - on the American concept of combining hard work and risk of capital to make a new idea pay off, and affording these companies equitable treatment and a chance to live and develop.

Finally, we do not believe it is the public interest to make it impossible for new successful businesses to grow and develop. A tax law is wrong if it tempts persons to sell out, take a capital gain, and go fishing.

We do not feel that anybody else knows our business as well as we do, and we want it to continue under our ownership and management.

This must likewise be true of a great many businesses similar to ours. I am certain that it was not the wish of Congress to discourage the effort and risk of developing new businesses, the very principle which has made America the greatest and strongest country in the world.

Our tax bill from Uncle Sam since we began operations in November of 1947 now totals over half a million dollars. New enterprises can thus be productive of substantial revenue if given a fair chance to prosper.

But unless there is relief from the deadly effect of the present excess-profits tax, I feel compelled to observe that the Treasury will not continue large collections from our business and similar companies, for the simple reason that we won't be in business. Our tax liability on December 31, 1950, exceeded our cash in the bank by $300,597.

Senator MILLIKIN. How would you get the money to pay off?

Mr. CHAMBERS. If sales continue, Senator, during this year, by borrowing from the bank. We have a credit line of a quarter of a million dollars now, and we can pay. If business dropped off, sir, we would be in dire straits.

Senator KERR. You would be sunk in the ditch, is that right?

Mr. CHAMBERS. That is right, sir.

Senator KERR. Have you got a suggestion as to how we could meet a situation like that?

Mr. CHAMBERS. Senator, I realize the problem has many facets, and I have not presumed to reduce to legislative language a solution of the problem.

In general terms, however, it would seem to me provision could be made for companies during the first, perhaps, 5 years of their existence to be exempt from excess-profits taxes, especially in the light of the fact that the surtax plus the normal tax will be 50 or 52 percent.

Certainly any company which was founded prior to Korea has a better chance under that provision than they are going to have under today's law to become tax-paying units.

There are, perhaps, other modifications and conditions which would be possible, such as if you invested those funds the amount of the excess-profits tax, in plant you would not pay excess-profits tax—I am sure the tax experts would have a better point of view than we do.

As a bare minimum, though, we feel that the present growth formula should be broadened to include us, and that a base period should be devised which would be equitable.

Senator KERR. Regardless of the fact that you did not start until after 1946?

Mr. CHAMBERS. That certainly is correct.

From a standpoint of potential revenue to the United States Treasury the effect of the present law is damaging, and shortsighted, in that it actually represents a long-term loss of revenue. Companies which have been formed in the last 4 or 5 years and are now beginning to succeed can double, treble, and quadruple their present size in the next 5 to 10 years if permitted to realize their normal growth potential.

Not only will this contribute to the Nation's industrial strength and create employment; it will place these companies in a position of paying, and being able to pay, normal taxes after they have attained their growth far in excess of the amount of so-called excess profits tax demanded of them now.

We appear here today, therefore, to ask that you make it possible for new business to continue to exist and develop, and to remove the ironic misfortune of being too successful to raise the cash to pay the resulting taxes; and too young to have access to the only relief provided by the law. We cannot thrive if we are to be classed and taxed as realizers of swollen war profits.

Senator HOEY. Thank you, Mr. Chambers, for your appearance and your statement.

Mr. CHAMBERS. Thank you.

Senator HOEY. Mr. Joseph C. White. Have a seat, Mr. White, and give your name and connections to the reporter, please, sir.

STATEMENT OF JOSEPH C. WHITE, REPRESENTING THE EQUITABLE OFFICE BUILDING CORP.

Mr. WHITE. My name is Joseph C. White. I am a New York City lawyer representing Howard S. Cullman, chairman of Equitable Office Building Corp., and I am speaking on behalf of that corporation, and I assume that my remarks will be applicable to similar controlled real-estate corporations.

In response to the suggestion in Senator Byrd's letter to Mr. Cullman, I am going to restrict my oral remarks to a mere outline of our position, and have submitted to the committee a brief but more extended statement.

Senator HOEY. Your full statement will appear in the record.

Mr. WHITE. Thank you, Senator.

I want to make it clear at the outset that I am not raising any question as to an increase in taxation in general, and I am not raising any question as to the imposition of an excess profits tax on profits due to the military and defense expenditures.

I only wish to submit for your consideration the situation of controlled real-estate corporations where, I believe that the present law imposes an excess-profits tax on profits which are not due to such governmental expenditures and, therefore, are not, in fact, excess profits.

The primary test presented by the act for determining what are excess profits is to take as normal earnings a percentage of the average earnings for the base period and to deem any profits in excess thereof to be excess profits subject to the tax.

But in our case, in the case of Equitable Office Building Corp., the earnings for the base period were subnormal for two reasons:

First, throughout the base period the corporation was subject to rent control;

Second, during the first half of the base period the corporation was still in reorganization under chapter 10 of the bankruptcy law.

The average earnings of the base period do not, therefore, give a fair basis for determining excess profits.

Moreover, in the case of corporations renting business property, as distinguished from residential property, the act distinctly discriminates against corporations operating in New York City which, I believe, is the only important area where rental of business property was controlled during the base period.

As a substitute for average base-period earnings, the act permits a corporation to take a credit based on a percentage of its capital, but this is a very hit-or-miss substitute for the determination of what are normal earnings, and the present act itself shows that such credit is not deemed to be an adequate substitute in the case of public utilities, the earnings of which were depressed during the period by governmental regulations, that is, regulations – they are granted relief under section 448, and we are merely asking that controlled real-estate corporations be granted relief similar in nature.

To indicate the type of relief which is worthy of the consideration of your committee, I have drafted and have also submitted to the committee, together with my statement, possible amendments to the act.

Thank you.

Senator HOEY. Thank you very much. We are very glad to have your statement. It will be put in the record.

Mr. WHITE. Thank you, Senator Hoey.

(The prepared statement of Mr. Joseph C. White, referred to, is as follows:)

STATEMENT OF JOSEPH C. WHITE ON BEHALF OF EQUITABLE OFFICE BUILDING CORP.

The purpose of this memorandum is to show that real-estate corporations which were subject to rent control during the base period are entitled to relief from the existing provisions of the Excess Profits Tax Act of 1950.

The Excess Profits Tax Act of 1950 imposes a tax of 30 percent on excess profits. Senate Report No. 2679, Eighty-first Congress, second session, page 3, states the purpose of the act as follows:

"Your committee conceives of this tax as primarily a tax on increased profits due to the outbreak of hostilities and to large military expenditures. This accounts for the primary emphasis upon the average-earnings base."

The average-earnings base so referred to is the average of annual profits for various periods during the four calendar years 1946 to 1949 known as the base period. Profits in excess of 85 percent of such average are deemed excess profits.

The Excess Profits Tax Act of 1950 is, therefore, designed to impose an additional tax on increased profits due to the outbreak of hostilities in Korea and to large military expenditures to be made; whereas, on the other hand, the increases in corporate normal tax and surtax provided by Congress are designed to levy a contribution to the defense effort from profits whether or not increased on account of the present emergency. This memorandum does not raise any question as to increased taxation except excess-profits taxes on profits which can be shown not to have been excess profits.

In general the base period was a prosperous period for corporations. Certain corporations and certain industries, however, could not take advantage of the prosperity of the base period and Congress, accordingly, has prescribed in the act relief for those corporations and industries such as, for example, regulated public utilities the income of which was subject to governmental limitation. Such relief, however, has not been extended to real-estate corporations owning and operating office buildings and multiple dwellings the earnings of which were restricted by limitations in the form of rent controls.

Federal rent controls were originally introduced by the Emergency Price Control Act of 1942 administered by the Office of Price Administration. The present controls are based on the Housing and Rent Act of 1947 as amended. Under the latter act controls were removed in many parts of the country during the base period but in others they were continued. Increases in maximum rent have taken place within narrow limits fixed by law but the old OPA rules which by and large are based upon the rent level of 1941 and 1942 continue to be the foundation of the maximum rent. Notwithstanding such increases as have occurred, rental income has not kept pace with the increased earnings which have occurred since 1942 in other industries.

If the average costs of living in the period 1921 to 1938 are indicated by the figure 100, the index of residential rents increased in the country as a whole from the end of World War II to the end of 1950 from 86.50 to 99.7, or by 13.2 points or about 15 percent, the cost of fuel and light rose from slightly over 100 to 130.9, and of all items from slightly over 115 to 161. See Real Estate Analyst, volume 19, No. 54; volume 20, No. 1. The cost of living in general increased from 115.5 to 155.7, or by 30.2 points or about 33 percent. See Real Estate Analyst, volume 20, No. 1.

The same result is shown by figures published by the Bureau of Labor Statistics.

It is thus apparent that owners of real estate did not share in the general prosperity. Since the foregoing figures included controlled and uncontrolled space they are weighted against the owners of controlled space since as a matter of common knowledge controlled space does not yield the same rent as uncontrolled.

In New York City rents from commercial and business property were also severely restricted under two State statutes enacted in January and March 1945. The basis of those restrictions are rentals existing on March 1, 1943, for commercial property and on June 1, 1944, for business property. Increases in such commercial and business rents have been from time to time under some circumstances permitted. At the present time the New York Supreme Court, which regulates the amount of increases, will not grant an increase of rent to yield a net return (computed before Federal tax on income) in excess of 8 percent of the fair market value of the property, which fair market value is prima facie deemed to be equal to the assessed valuation.

As a result of Federal and State control, the return from real-estate investments became uneven as between different geographical areas throughout the United States and also uneven within the different areas. The New York and Federal rent-control statutes provide for exemption for so-called new buildings and for space which became decontrolled under various circumstances. To illustrate the point: The cost of 1 square foot of uncontrolled space in New York City in buildings comparable to Equitable Office Building Corp. was in excess of $4.50 during the base period. During the same period Equitable Office Building Corp. was able to obtain on the average the following amounts for each square foot:

1946	$2.60
1947	2.94
1948	3.16
1949	3.47
1950	3.83

This divergence is a direct consequence of the New York rent controls. If those controls had not been in existence the price which Equitable Office Building would have obtained during the base period would have been at least $3.83 if not substantially more.

During all that period Equitable Office Building was practically fully rented. The occupancy percentage has increased only insignificantly from 98.2 in 1946 to 99.4 in 1950. With one or two exceptions none of the space was subject to long-term leases during the base period.

It is thus apparent that average earnings in the three best years during the base period do not represent a fair measure of normal profits. Moreover, as a consequence of the great depression, Equitable Office Building Corp. was compelled to avail itself of the reorganization provisions of chapter X of the Bankruptcy Act. In the years from 1937 to July 1950 the corporation was unable to pay any dividends to its stockholders. A plan of reorganization was finally consummated in December 1947 which, among other provisions, provided that old stockholders would have to subscribe to new shares of the corporation if they desired to retain their old investment.

The Excess Profits Tax Act provides as an alternative to the income credit a credit based upon invested capital but, in the case of real-estate corporations, the earnings of which were controlled during the base period, a return on capital which does not recognize the fair market value or reproduction cost of the property is not an adequate substitute for a credit based on income.

The base period generally was a period of high costs of construction and accordingly corporations owning structures erected prior to the base period are capitalized far below the true base-period value of their property. Moreover, they were heavily indebted and subject to high charges for interest and amortization. Their profits are limited by the amount of floor space they have to rent although the expenses for labor, maintenance, and taxes were increasing continuously. Thus in the case of Equitable Office Building Corp. operating expenses during the base period increased by nearly 60 percent from $1,048,000 to $1,600,000. For those reasons the credit provided by the invested-capital method is not representative of normal profits.

To sum up: The profits of the real-estate industry in controlled areas were held down well below the profits earned by uncontrolled industries with the exception of finance and insurance, which represent a special category. The average base-period rate of return of real estate as published by the Secretary of the Treasury under the provisions of section 447 of the Internal Revenue Code is 5.3 percent. Only railroads, transportation by air, and telecommunications received a lower rate of return; all other utilities enjoyed a higher rate. All those industries were given a special relief by section 448 of the Internal Revenue Code by being allowed to earn 6 or 7 percent on their equity and borrowed invested capital (plus the corporate normal tax and surtax) before becoming subject to excess-profits taxes.

As the report of this committee stated, this provision was appropriate "in view of the fact that the profits of these industries in the base-period years were held down well below the profits of uncontrolled industries."

Another purpose of Congress in providing the minimum credit was to establish "uniformity for purposes of determining income which should be subjected to excess-profits tax."

As mentioned before the rent-control laws provide for a regulation of rent by governmental bodies. In the case of the New York business and commercial rent-control laws the statute further provides for a narrow limit within which increases in rent can be obtained from such bodies.

Since the excess-profits tax is designed to tax increased earnings, resulting directly or indirectly from the defense effort, a base-period credit which does not take into account the limitation on earnings imposed during the base period by rent-control regulations will result in a tax upon earnings which are not due to the increased defense spending. Moreover, those corporations operating in decontrolled areas or leasing uncontrolled space in controlled areas are allowed to establish their credit on the basis of unrestricted earnings during the base period. This results in a discrimination not only as compared with other industries, but also within the same industry.

If on the other hand a real-estate corporation is allowed to earn a rate of 7 percent on its invested capital plus corporate normal tax and surtax, this differential will be eliminated and real-estate corporations will be given a fair basis for determining what are excess profits. Any profits attributable to rent increases during excess-profits-tax years which might be held attributable to the defense effort, will be subject to the excess-profits tax.

Corporations which undergo reorganizations under chapter X of the Bankruptcy Act are restricted in their operations by trustee management under the supervision of the court. Trustee management is by its nature reluctant to take risks. Consequently, earnings of corporations which were in reorganization during the base period are not representative of the earnings of similar industries. It is therefore suggested as a further relief that corporations in reorganization be given a 5-year period after consummation of the reorganization of freedom from excess-profits tax for rehabilitation under ownership management. This is a minimum period required to build up a financial status which will permit such corporations to compete on equal terms with nonreorganized businesses. It seems not in accordance with the purpose of the excess-profits tax to levy during that period an excess-profits tax which is based on inadequate prior earnings.

SEC. 448A. EXCESS PROFITS CREDIT CONTROLLED REAL ESTATE CORPORATION

(a) AMOUNT OF CREDIT. In the case of a controlled real estate corporation (as defined in subsection (c)), the excess profits credit for any taxable year computed under this section shall be the sum of the tax imposed by sections 13, 14, 15, and 141 (e), for such taxable year and the amount determined under subsection (b).

(b) COMPUTATION. The amount referred to in subsection (a) for any taxable year shall be determined as follows:

(1) by applying 7 per centum to the sum of the following:

(A) the adjusted invested capital for such taxable year, and

(B) the average borrowed capital for such taxable year as defined in section 439.

For the purposes of this paragraph the adjusted invested capital for any taxable year shall be the amount computed for such year under section 437 (b) (2) without reduction by the amount of the net new capital addition and without regard to section 437 (b) (2) (C).

(2) by reducing the amount ascertained under paragraph (1) by the deduction allowable for such year with respect to interest on indebtedness included in borrowed capital under section 439.

(3) by reducing the amount ascertained under paragraph (2) by the amount computed under section 440 (b) (relating to inadmissible assets).

(c) For the purposes of this subchapter the term "controlled real estate corporation" means (except as provided in subsection (d)) a corporation engaged as owner in fee or as lessee under a lease of real estate (improved or unimproved) with an original term of 30 years or more in the business of leasing space in buildings, but only if at least 80 per centum of its gross income during the taxable year is derived from rent and if during each year in the base period (as defined in section 435 (b))—

(A) 80 per centum or more of the available floor space was, under the Emergency Price Control Act of 1942, as amended, the Housing and Rent Act of 1947, as amended, or any law of the District of Columbia or any territory or possession of the United States, or of any State or political subdivision thereof,

(i) subject to rent ceilings, or

(ii) subject to restrictions on evictions, or

(iii) rented under leases entered into pursuant to any such law; and

(B) 80 per centum or more of its gross income (computed without regard to dividends and capital gains and losses) was derived from rents

The term "rent" as used in this section shall include income derived from rendering services and other income incidental to the business of lessors of buildings.

(d) CONSOLIDATED RETURNS OF CONTROLLED REAL ESTATE CORPORATIONS.—(1) For purposes of this section an includible corporation (as defined in section 141 (e)) shall not include any controlled real estate corporation which has made and filed a consent, applicable to the taxable year, to compute its excess profits credit without regard to this section. The consent shall be made and filed at such time and in such manner as may be prescribed by the Secretary. The consent shall be applicable to the taxable year for which filed and to each consecutive subsequent taxable year for which a consolidated return is filed.

(2) For purposes of computing its excess profits credit under this section, a common parent corporation shall be deemed a controlled real estate corporation if at least 80 percentum of its gross income (computed without regard to capital gains and losses) is derived directly or indirectly from controlled real estate corporations.

(3) Despite the provisions of paragraph (1) of this subsection, two or more controlled real estate corporations, each of which has made and filed a consent, applicable to the taxable year, to compute its excess profits credit under this section only, shall be considered an includible corporation for the purpose of the application of section 141 (d) to such controlled real estate corporation alone.

The consent shall be made and filed at such time and in such manner as may be prescribed by the Secretary. The consent shall be applicable to the taxable year for which filed and to each consecutive subsequent taxable year for which a consolidated return is filed.

CORPORATE REORGANIZATIONS UNDER CHAPTER X OF THE BANKRUPTCY ACT

(1) DEFINITIONS.—As used in this subsection—

(A) REORGANIZATION, PLAN OF REORGANIZATION.—The terms "reorganization" and "plan of reorganization" shall have the same meaning as in Chapter X of the National Bankruptcy Act as amended.

(B) REORGANIZED CORPORATIONS.—The term "reorganized corporation" means—

(i) a corporation with respect to which a plan of reorganization was consummated within the sixty-month period next preceding the end of its taxable year which ends with or within the calendar year 1950; and

(ii) a corporation which was organized pursuant to a plan of reorganization of another corporation consummated within the sixty-month period next preceding the end of the taxable year which ends with or within the calendar year 1950.

(2) EXEMPTION.—A reorganized corporation shall not be subject to the tax under this subchapter for a period of sixty months following the end of the month in which a plan or reorganization was consummated.

(3) ALTERNATIVE EXCESS PROFITS CREDIT.—After the expiration of the period provided in subparagraph (2) the excess profits credit based on income shall not be less than the excess profits net income of the reorganized corporation for the taxable year preceding its first taxable year under this subchapter.

Senator HOEY. Mr. Henry S. Moser, Allstate Insurance Co.

Please give your name and connection to the reporter, please, sir.

STATEMENT OF HENRY S. MOSER, GENERAL ATTORNEY, ALLSTATE INSURANCE CO.

Mr. MOSER. My name is Henry S. Moser, and I am general attorney for the Allstate Insurance Co., of Chicago, Ill.

The Allstate Insurance Co. is a stock casualty company. It was organized in 1931 and writes automobile insurance only.

All of its stock is owned by Sears, Roebuck & Co. Continuously since its organization it has sold insurance at 15 to 20 percent below manual rates.

By manual rates I mean those rates which are generally charged by the 107 companies that are members of the National Bureau of Casualty Underwriters.

It had a very rapid growth in premium income during its base period, as shown below:

1946	$15, 418, 000
1947	19, 908, 000
1948	31, 694, 000
1949	40, 906, 000

Notwithstanding the company's growth during the base period and notwithstanding the company's assets as of the beginning of the base period were less than $20,000,000, the present Excess Profits Tax Act denies to it the benefit of the growth formula by reason of the fact that it was a member of an affiliated group having assets at the beginning of the base period of more than $20,000,000. A factual study and analysis by Alfred M. Best & Co., insurance statisticians, a copy of which is attached to this statement, discloses that only eight other insurance affiliates are in the same situation. The denial of the growth formula to these nine insurance affiliated companies results in substantial hardship and inequity.

The inequity arises in the application of section 435 of the act prescribing the method of computing a taxpayer's excess-profit credit. When the section is applied to these nine insurance affiliates, it produces the following unintended and anomalous result. It requires such companies in effect, in computing their excess-profit credits, to average their respective earnings during their periods of growth, periods when their book earnings were understated or very much less than their true earnings, and to apply such credit or average of understated earnings in future years to book earnings which are grossly overstated.

This is occasioned by the following facts:

The insurance industry differs from almost all other industries in respect of treatment of prepaid expenses and deferment of income. In the insurance business prepaid expenses are large and their influence on taxable earnings is substantial. The State insurance regulatory bodies, with a view toward policyholders' protection and to insure the ulitmate in liquidity, properly require accounting methods whereby insurers are treated substantially as on a liquidation basis. Thus they refuse to recognize as assets prepaid expenses, including such substantial items as commissions to agents, advertising, State premium taxes, and so forth, and require their immediate write-off. On the other hand, they require premiums to be treated as a liability to be taken into income periodically over the term of the policy. Approximately 50 percent only of the premiums written in any calendar year is treated as earnings in that year; the remainder is earned in the succeeding calendar year. Thus, although nearly all of the expenses incurred in the sale and writing of policies must be charged off in the calendar year in which the policies are issued, only one-half of the premiums written during said year are treated as earnings in that year.

Writing off prepaid charges immediately and deferring 50 percent of premium income does not have, over a period of years, a substantial effect upon the normal tax or surtax of an insurance company. Assuming the tax rate does not decrease, the Government, though collecting from a growing insurance company less normal tax and surtax during the period of growth and higher taxes thereafter, collects, over a period of years, about the same aggregate amount as it would have collected had prepaid charges not been written off in the years they were disbursed and had premium incomes not been deferred.

However, it is a vastly different story with respect to excess-profits taxes. The effect of the State regulatory requirement upon insurance companies to write off prepaid charges and to defer 50 percent of premium income in relation to the Excess Profits Tax Act in the case of a growing company is—

1. To understate the earnings during a period of growth. When growth occurs during the base period, the base-period earnings are therefore understated;

2. To afford an inadequate excess-profits credit if computed under the general average earnings method;

3. To overstate the earnings when (*a*) the rate of growth is retarded, (*b*) growth ceases, or (*c*) when there is a decline in premium writings;

4. To require under the general average earnings method the application of an understated excess profits credit to overstated earnings when growth is retarded, ceases, or when premiums decline.

The above effects are illustrated in a hypothetical case in exhibit B, which is attached to my statement herewith.

It is to be noted that in this example the company, though having an increase of $7,600,000 in premiums during the last year of the base period as compared with the first year, had recorded earnings during the base period of only $710,000 by reason of writing off prepaid expenses and deferring approximately 50 percent of its premium income. Its excess-profits credit, on the general average earning method, was only $540,000. In the 3 years next following, however, when the rate of growth first became retarded, and later when premium income declined, the recorded earnings of the company soared to $975,000, $1,660,000, and $2,470,000, respectively.

The rate of growth during the base period of the nine insurance affiliates heretofore mentioned, taken as a group, to whom the growth formula was denied was as follows: 1947, 75.1 percent; 1948, 62.1 percent; 1949, 54.1 percent. The rate of growth of said companies in 1950, taken as a group, was only 16.1 percent. The inequity of limiting said companies to the general average earnings method of determining excess-profits credits, without benefit of the growth formula, and requiring them to apply an understated excess-profits credit to overstated earnings is apparent. An excess-profits credit determined under the invested-capital method in our case produces even a smaller credit than if computed under the general average earnings method. We believe this is true for each of the other eight affiliates involved.

The Congress for many years has recognized the fundamental differences between insurance and other industries and has provided by section 204 for the taxation of insurance companies in a manner different than that for industries generally. This difference in treatment, though adequate and proper with regard to normal and surtax problems, is inadequate to relieve the growing insurance affiliate from a gross inequity in the application of section 435. This inequity is peculiar to insurance affiliates. Noninsurance affiliates are not generally confronted with any problem of writing off substantial prepaid charges and deferring income. Consistency, it seems to us, requires a further implementation of the distinction in the computation of excess-profits credits between insurance affiliates and noninsurance affiliates.

Let me point out another inequity and discriminatory feature of the Excess Profits Tax Act as applied to nearly all of the nine companies heretofore mentioned. A stock fire or casualty company which had assets of less than $20,000,000 as of the beginning of the base period, if owned by a life-insurance company whose assets if added to the assets of its subsidiary were in excess of $20,000,000, is not denied the benefit of the growth formula. Likewise, a stock fire or casualty company with assets as of said date of less than $20,000,000 if owned by a mutual insurance company, whether fire, casualty, or life, is not denied the benefits of the growth formula regardless of the assets owned by such mutual company at the beginning of the base period. In our State alone, if the committee please, there are four, to our knowledge, stock fire and casualty companies with assets of less than $20,000,000 as of the beginning of the base year—the base period—that were owned by mutual companies whose assets far exceeded $20,000,000, and they are our competitors, and they get the benefit of the growth formula, but our company, because it is not owned by a mutual company or a life company, is denied that benefit.

Such stock fire and casualty companies may avail themselves of the benefits of the growth formula since they did not have the privilege of filing a consolidated return with their parent company. Section 141 provides that life companies may file consolidated returns only with other life companies, and that mutual companies may file such returns only with mutual companies.

Thus, merely because our company is a subsidiary of a group having assets in excess of $20,000,000 at the beginning of the base period, the benefit of the growth formula is denied to it. This is not true with respect to any subsidiary stock fire or casualty company of the John Doe Mutual Insurance Co. or the John Doe Life Insurance Co., irrespective of the amount of their aggregate assets.

In conclusion, it is respectfully submitted:

1. The Excess Profits Tax Act, in denying the benefits of the growth formula to certain insurance affiliates, singles out in its operation a few companies and subjects them to adverse treatment. It fails in that respect to create broad classifications generally considered equitable for tax purposes.

2. The act unfairly places insurance affiliates in the same category with noninsurance affiliates. It fails to recognize the distinct difference between such affiliates arising out of the insurance State regulatory requirements requiring, in the case of insurance companies, the immediate write-off of prepaid charges and the deferment of substantial portions of income.

3. The act, in relegating an insurance affiliate such as our company to the "general average earnings" method in computing its excess-profit credit, results in requiring the use of a grossly inadequate credit and in substantial hardship and inequity.

4. The act imposes upon stock fire and casualty affiliates not owned by mutual or life insurance companies discriminatory treatment—treatment wholly different than that applied to a stock fire or casualty insurance affiliates of mutual or life insurance companies.

5. The loss, if any, in taxes to the Government by legislative relief from the inequity and hardship heretofore described cannot be substantial. The denial of the growth-formula benefits to the nine companies afore-mentioned may, in fact, result in less tax revenue to the Government. Four of the nine companies have had growth, in part, because of economical operation and their sale over a period of years of insurance at rates considerably less than "manual rates." Increased tax burdens upon these four companies and resulting competitive disadvantages may make it difficult for them to continue to maintain their present premium differential. This may well result in less business—less profits—and less taxes.

Briefly, it seems to us we have been put in the wrong slot. We are put in a so-called slot of noninsurance affiliates whose accounting method is entirely different, who are not required to write off prepaid charges or defer income.

We have been taken out of the slot, it seems to us, where we should have been placed, in the same situation as the stock fire and casualty companies that are owned by mutual companies or owned by life companies.

What is the remedy? There are many. We have taken the liberty of suggesting one—the addition of a few words to section 435.

A draft of the amendment or amended section is attached to this statement.

Senator HOEY. That will be considered and put in the record.

Mr. MOSER. May my memorandum be filed and made a part of the record?

Senator HOEY. Yes, sir.

Mr. MOSER. Thank you, sir.

(The document referred to, Analysis of Domestic Stock Casualty and Fire Insurance Companies Doing Business in 1950, exhibit B mentioned in the statement, and exhibit C, a draft of the suggested amendment, follow:)

EXHIBIT A

Analysis of domestic stock casualty- and fire-insurance companies doing business in 1950 [1]

1. Total companies 477
2. Less companies with assets over $20,000,000 at beginning of base period 78

 Companies with assets under $20,000,000 at beginning of base period 399

3. Less nonaffiliated companies and companies affiliated in groups with assets less than $20,000,000 at beginning of base period 319

 Companies affiliated in groups with assets in excess of $20,000,000 at beginning of base period 80

4. Less:
 Companies not qualifying for growth formula by either increase in sales or payroll 36
 Companies whose excess-profits tax credit was larger under general average earnings or invested capital bases than under the growth formula 35
 71

5. Affiliated companies whose excess-profits credit would have been larger if the growth formula had not been denied them 9

[1] Prepared by Alfred M. Best & Co.

EXHIBIT B

Example showing effects of charging off prepaid expenses and deferring premium income on company with premium growth during base period

[000 omitted]

	1946	1947	1948	1949	1950	1951	1952
Premiums written	$8,000	$10,000	$12,500	$15,600	$19,500	$21,450	$19,300
Percent increase over previous year	....	25	25	25	25	10	−10
Premiums earned from premiums written in previous year (50 percent)	0	$4,000	$5,000	$6,250	$7,800	$9,750	$10,725
From premiums written in current year (50 percent)	4,000	5,000	6,250	7,800	9,750	10,725	9,650
Total	4,000	9,000	11,250	14,050	17,550	20,475	20,375
Losses: 50 percent of premiums earned	2,000	4,500	5,625	7,025	8,775	10,237	10,187
Expenses: 40 percent of premiums written (commissions, 25 percent; other, 15 percent)	3,200	4,000	5,000	6,240	7,800	8,580	7,720
Total	5,200	8,500	10,625	13,265	16,575	18,817	17,907
Underwriting profit or loss	−1,200	500	625	785	975	1,658	2,468

1. Average base-period net income (general average) $636,000
2. Excess-profits credit (85 percent of 1) 540,000
3. Average base-period net income (alternative based on growth) 785,000
4. Excess-profits credit (85 percent of 3) 667,250

EXHIBIT C

SUGGESTED AMENDMENT TO SECTION 435 (e) (1) (A) (i) OF EXCESS PROFITS TAX ACT OF 1950

[New language shown by italics]

"(e) AVERAGE BASE-PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH—(1) TAXPAYERS TO WHICH SUBSECTION APPLIES.—A taxpayer shall be entitled to the benefits of this subsection if the taxpayer commenced business before the beginning of its base period, and if either—

"(A) (i) the total assets of the taxpayer as of the first day of its base period (when added to the total assets for such day of all corporations with which the taxpayer, *if other than a corporation taxable under section 204*, has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter), determined under paragraph (3), did not exceed $20,000,000, and".

Senator HOEY. Our next witness is Mr. George Roberts of the American Bar Association.

Mr. Roberts, will you please have a seat, sir, and give us your name and connection, please.

STATEMENT OF GEORGE ROBERTS, CHAIRMAN, SPECIAL COMMITTEE ON RETIREMENT BENEFITS FOR LAWYERS, AMERICAN BAR ASSOCIATION

Mr. ROBERTS. My name is George Roberts. I have been a practicing lawyer since 1908, and I appear here as chairman of a special committee of the American Bar Association on retirement benefits for lawyers.

I am here to ask you to give consideration to a proposed amendment to the revenue bill in aid of voluntary savings for professional men and other taxpayers who are not covered by a corporate pension under section 165 of the code.

I believe that you, as lawyers, know that lawyers and other professional men are not included in these pension plans which are limited to corporations and for which the corporation gets a tax deduction with respect to its contributions.

I am here asking that this inequity be cured.

The board of governors of the American Bar Association passed the following preamble and resolution, which summarizes the proposition:

Whereas the present high levels of Federal taxation on earned income make it virtually impossible for professional persons and other recipients of earned income to provide for their retirement from their income; and

Whereas the problem of providing retirement benefits has, to a great extent, been solved by corporate employees by section 165 of the Internal Revenue Code; and

Whereas the need for such retirement benefits is equally great in the case of professional persons and other persons having earned income but not covered by a pension plan: Now, therefore, be it

Resolved, That the board of governors of the American Bar Association favors in principle amending the Internal Revenue Code so that taxpayers not covered by a pension plan qualified under section 165 of the code, may be encouraged by a tax credit, a tax deduction or other means to accumulate, out of current earned income, funds which would be available under appropriate regulations of the Treasury Department to provide retirement income for such taxpayers.

It happens that yesterday Senator Ives introduced in the Senate an amendment to the pending revenue bill, which would cover this question. He also introduced a statement which is in this morning's Congressional Record at page 9055, and I wish every member of this committee would read it because it is a much better statement than I have prepared. I now ask you to give consideration to Senator Ives' amendment, and to the explanation of it which is in this morning's Congressional Record.

The proposal, which is an amendment, would permit a taxpayer who was a member of a bona fide agricultural, labor, business, industrial, or professional association, to pay into a trust fund, forming part of a retirement plan set up by such an association, an amount in any one year not exceeding 10 percent of his earned income. In no event, however, is this to be more than $7,500 and for it he is to receive a deduction, for Federal income-tax purposes, for such amounts so paid in.

The trustee, which has to be a bank, a member of the Federal Reserve System, then manages these moneys as a common trust fund, placing them in investments legal for trust funds. On the man's retirement or death, the trustee pays it back pays back to each man what he put in, with the accumulations. It may be payed back either in a lump sum or in installments, and when he gets it back, the recipient has to pay an income tax in accordance with the then existing law.

It is true that in many cases this will mean that the tax will be remitted in a man's most productive years when his income-tax bracket may be higher than it will be in his later years when his earning power has diminished, or is nonexistent, and when his income may be lower.

This is true of doctors and lawyers; it is more true, of course, in the case of singers, ball players, and other people where age is more important than it is in the professions, but I think it is true that lawyers, doctors, accountants, almost everybody, go through a period of small earnings in the beginning, as you know doctors have to spend years, so do lawyers getting ready to practice and then they have a high income-producing period and then in the later years, particularly in the case of most lawyers who are practicing for themselves most lawyers are not, as I am, a member of a firm, they are individual practitioners and their incomes go down.

Senator TAFT. What is the advantage of permitting a deduction for payments into such a fund, and not permitting a deduction of payments in life-insurance companies?

Mr. ROBERTS. You say why shouldn't you?

Senator TAFT. Yes. You have had the life-insurance companies often before us, urging that a certain amount of life insurance should be deductible.

Mr. ROBERTS. Well, there is, I think, much to be said in favor of that, but——

Senator TAFT. This would require the association to set up a pension fund.

Mr. ROBERTS. Yes, sir. It requires some association to set up what is really a savings fund that is more than a pension fund. It is a savings fund which you cannot take out until you retire or die or are totally disabled. It differs from an ordinary pension fund in that an ordinary pension fund is one that provides that the owner is to receive X dollars every month.

These funds could not do that because they pay people back, who have paid in, plus any profits or accumulations that the fund has made or less any losses that the fund has sustained.

Senator TAFT. Are you familiar with the plan presented here to us at the beginning of the hearings of the 5-percent investment in a form of Government bonds?

Mr. ROBERTS. The so-called Salverson plan?

Senator TAFT. Was that submitted by the New York State Bar?

Mr. ROBERTS. No, sir. I think that was submitted by Mr. Salverson on his own behalf, but that plan has been considered and has been approved by many bar associations.

Others objected to it because, in the first place, it brings in this new idea of a special kind of Government security. Did he recommend 5 percent? I thought it was a bond of only 1 or 2 percent.

Senator TAFT. No; 5 percent of the income. The bond itself, I do not know whether that carried only 1 or 2 percent, but you have here 10 percent of the income.

Mr. ROBERTS. Yes; I have 10 percent.

Senator TAFT. He limited it to 5 percent of the income, and 10 percent is a little high, that is, if I think you are trying to make it parallel to other pension funds.

Mr. ROBERTS. That is what I am trying to do, Senator.

Senator TAFT. Those pension funds, as a rule, do not run over 5 or 6 percent at the outside. I think we Senators pay 6 percent.

Mr. ROBERTS. Well, I do not know about your pension.

Senator TAFT. I think that is about as high as anybody, unless the railroad people I do not think even the railroad people I do not think the railroad retirement fund runs over 6 percent 6½ percent, I think, for the men themselves.

Mr. ROBERTS. Of course, a great many of these corporation pension funds are made up of funds that are really put in by the stockholders for the benefit of the employees, and there are a hundred stockholders often to one employee. While this enables these professional people, in effect, to set up their own pension funds, there is nobody who takes the place of a stockholder. They have to put it up out of their own money.

Senator TAFT. Yes, sir.

I think the Government contributes an equal part in civil-service funds and also the railroad does in the 6 percent, too. In this case the man has to put it all up. He has no employer, so he pays himself, he has to put the whole amount up, himself, so I do not suppose 10 percent would be out of line with the general idea of the pension funds now current in industry.

Mr. ROBERTS. I think you will find that financially if you adopted this amendment there would still be a great edge in favor of being employed by a corporation as an officer or an employee, as compared with being out for yourself. This amendment, if adopted would tend, certainly, to equalize the burden.

Senator TAFT. The deductions for payments into the pension funds are quite elaborate. The regulations are quite elaborate as to the qualifications of that fund, and no doubt the Treasury, if you did anything of this sort, would want to impose some fairly strict restrictions on just how this fund could be managed.

Mr. ROBERTS. I would have no doubt that that would be true. I became interested in this problem several years ago because I talked to so many lawyers—young lawyers and young doctors and young architects. They really are most discouraged, and I have known several in our own office. I think we have had four people leave us within a fairly short period of time to go into a corporation. I asked them why, and they said, "We cannot save anything. If we go into this corporation, we will get into a pension fund."

I do not think the law ought to discourage young men from going into the professions and encourage them to go in as employees or officers in these corporations. The bigger the business, the better, because there are bigger pensions in big business.

Senator TAFT. Mr. Stam, do you have any comments?

You have been interested in this?

Mr. STAM. We have been very much interested in this particular plan, and I have talked to Mr. Roberts about it, and the problem, it would seem to me—the immediate problem before the committee would be the effect on the revenue of putting it right into effect, and I think that we talked, did we not, Mr. Roberts, about some idea of maybe having sort of a sliding scale where the deduction would not be as great for the first few years as for the last few, or something of that sort, so that the revenue lost would not be felt immediately; and in other words, to get the plan started, but not to feel the immediate effect on the revenue, and we would be glad to look into that angle of it.

Mr. ROBERTS. I want to get the thing started.

Let me point out one thing. This is an anti-inflationary measure.

We will all agree that inflation is our greatest domestic danger. One of the troubles is, according to the economists, there is too much money in the hands of consumers which will be spent for consumer goods, so they advocate increasing taxes just for the sake of taking money away.

They also advocate savings. If you can get people to save, that is the best possible way of reducing this inflationary gap.

President Truman, in his midyear economic report to Congress on Tuesday of this week, said, "voluntary saving is a part of a well-rounded anti-inflationary program."

This is true, and I know of no more effective way to encourage voluntary savings than this proposal to postpone from taxable income the amount of such savings under proper restrictions and limitations.

Senator HOEY. A great many State bar associations have become interested in this.

Mr. ROBERTS. I am sure you will find that very many State bar associations and county bar associations are interested; that the medical associations are interested; that the accountants organizations also are interested, and if I would have had time I would have taken this up with the various farmers' organizations because the farmers could come under this, too, the individual farmers, under their various associations, and a lot of others.

The societies of artists have communicated with me, and I am sure you will find that there is a very great interest in this. The substance of Senator Ives' bill came from bills introduced by Mr. Keogh and Mr. Reed, both members of the Ways and Means Committee, and they have been working with my committee and with the New York State Bar Association committee, of which Mr. Leslie M. Rapp is chairman, and the Association of the Bar of the City of New York, of which Mr. Roswell Magill is chairman.

Mr. Curt Pantzer of Indianapolis tells me that the Indiana Bar Association is very much interested in it. Mr. Pantzer, incidentally, is a member of the American Bar Committee.

I think you will find that there is tremendous interest in this among all professional men and other self-employed men.

Senator HOEY. Thank you very much.

Mr. ROBERTS. I hope you will give it serious consideration.

May I ask that our statement be printed, because I have not followed it very closely?

Senator HOEY. Yes.

(Mr. Roberts' prepared statement is as follows:)

STATEMENT OF GEORGE ROBERTS, CHAIRMAN, SPECIAL COMMITTEE OF AMERICAN BAR ASSOCIATION ON RETIREMENT BENEFITS FOR LAWYERS

My name is George Roberts. I have been a practicing lawyer since 1908 and am a member of the law firm of Winthrop, Stimson, Putnam & Roberts of New York City. I am chairman of a special committee of the American Bar Association on retirement benefits for lawyers.

I am here to ask you to give consideration to a proposed amendment to the revenue bill in aid of voluntary savings for professional men and other taxpayers not covered by a corporate pension plan under section 165 of the code. The basis of the proposal is to postpone from taxable income the amount of such savings, if made under an authorized plan. The objective is to lessen manifest tax inequities to lawyers, doctors, dentists, architects, accountants, actors, engineers and all others who depend for their livelihood on so-called earned income and are not the beneficiaries of a corporation pension plan.

My interest was aroused in this question by talks with young lawyers and other professional men who find it increasingly difficult to provide enough from savings to safeguard their retirement and to give their family any security on their death. The same type of young men with the same education who go into business receive protection by pension plans which are specifically authorized by section 165 of the Internal Revenue Code. Such pension plans are now practically universal in corporations of any size and they are favored by the law which permits tax deductions for the contributions made to such plans by the corporations.

No such tax deductions are given to self-employed, whether professional men or not, and as a result there has been a tendency on the part of young men who would like to be doctors, lawyers, architects or accountants, or who would like to enter some other profession, to give up the profession and go into business for the sake of the security afforded on retirement or death.

I submit, that from the standpoint of the country, this is not a healthy situation. We should encourage the professions and self-employment instead of discriminating against them.

The American Bar Association, and many State and local associations, have appointed committees to study this problem. The same has also been done by many medical associations and other associations of professional men.

The board of governors of the American Bar Association has passed the following preamble and resolution:

"Whereas the present high levels of Federal taxation on earned income make it virtually impossible for professional persons and other recipients of earned income to provide for their retirement from their income; and

"Whereas the problem of providing retirement benefits has to a great extent been solved for corporate employees by section 165 of the Internal Revenue Code; and

"Whereas the need for such retirement benefits is equally great in the case of professional persons and other persons having earned income but not covered by a pension plan: Now, therefore, be it

"*Resolved*, That the board of governors of the American Bar Association favors in principle amending the Internal Revenue Code so that taxpayers not covered by a pension plan qualified under section 165 of the code may be encouraged by a tax credit, a tax deduction or other means to accumulate, out of current earned income, funds which would be available under appropriate regulations of the Treasury Department to provide retirement income for such taxpayers."

Several bills have been introduced in the House of Representatives to help this situation. At the suggestion of our committee of the American Bar Association and of a similar committee of the New York State Bar Association, of which Mr. Leslie M. Rapp is chairman, and a committee of the association of the bar of the city of New York, of which Mr. Roswell Magill is chairman, House bills 4371 and 4373 were introduced on June 7 by Congressman Eugene J. Keogh and Congressman Daniel A. Reed, both members of the House Ways and Means Committee. Yesterday Senator Ives introduced an amendment to the pending revenue bill which embodies the substance of the above bills.

The proposal would permit a taxpayer who is a member of a bona fide agricultural, labor, business, industrial or professional association to pay into a trust fund forming part of a retirement plan set up by such an association, an amount in any one year not exceeding 10 percent of his earned income, but in no event more than $7,500, and to receive a deduction for Federal income tax purposes for such amount so paid in. The trustee managing such a trust, which has to be a bank which is a member of the Federal Reserve System, will then invest the amounts received by it in securities legal for trust funds. Upon retirement or death, the amount invested by the taxpayer, with accumulations, is paid back in accordance with the plan and these payments are then subject to tax under the Revenue Code.

In other words, this proposal is not a remission of tax but a postponement of tax. Of course, in many cases, this will mean that the tax will be remitted in a man's most productive years, when his income-tax bracket may be higher than it will be in his later years when his earning power has diminished or is nonexistent. At that time his income-tax bracket is presumably lower. This is particularly obvious in case of ball players, singers, and others whose earning power is greatly affected by age.

What we now ask is that this proposal be considered by you as an amendment to the revenue bill now pending before you.

If an amendment such as this is made to the code, it would not at all equalize the financial advantages of the professional man and self-employed as compared to the officers and employees of large corporations, but it would certainly tend in that direction and it would remove the discrimination now existing in favor of the corporate officers and employees.

Your committee is now considering a revenue bill which substantially increases individual income taxes and which gives no advantages to earned income over income from investments. In many cases these rates will make savings practically impossible. Is it not in the public interest that the hard-working individual who is on his own should be encouraged to save and to be independent in the good old American way? This is always important, but today it is particularly important. Everyone concedes that the great domestic danger today is inflation, and, if people can be encouraged to save, whatever money is so set aside is not available for expenditures on consumers' goods. The inflationary gap is to that extent lessened.

President Truman, in his midyear economic report to Congress on Tuesday of this week said: "Voluntary saving is an essential part of a well rounded anti-inflationary program." This is true and I know of no more effective way to encourage voluntary savings than the proposal to postpone from taxable income the amount of such savings. I urge your committee to give serious consideration to this problem.

Senator HOEY. This concludes the testimony of witnesses this morning.

In lieu of an appearance the Chair inserts in the record numerous statements and letters.

STATEMENT OF DAVID P. LIVINGSTON OF WASHINGTON, IOWA, AND ERNEST L. CAPPS OF LIBERTY, MO., ON BEHALF OF THE PURE BREED AND COMMERCIAL SWINE BREEDERS OF AMERICA

We are here today speaking in behalf of the swine industry. As a result of a joint meeting held on July 19, 1951, in Des Moines, Iowa, representatives of the National Swine Records Association, (representing 75,000 pure bred swine producers) and the Iowa Swine Producers Association (representing 192,000 pure bred and commercial swine producers), the following resolution was adopted to be communicated to the farm States congressional delegations:

"For Federal income-tax purposes—

"1. Sales of capital assets of all kinds are now taxable at 50 percent of the capital gain, provided said capital assets are held 6 months or more. H. R. 4473, section 117J (presently before the Senate Finance Committee, and which pertains to the sale of capital assets), has been amended to extend the holding period on livestock to 12 months before it could qualify for capital-gains treatment.

"2. The change of the holding period from 6 to 12 months on all livestock held for breeding, dairy, or draft purposes discriminates against some livestock producers and users.

"3. The adoption of this amendment would hamper the operation of both pure bred and commercial swine producers by creating new and arbitrary marketing practices to take any advantages of the provisions of this amendment. From an economic standpoint the general trend in breeding is to produce animals that will convert feed into pork at the lowest possible cost which, of course, means using the smallest amount of feed to produce 100 pounds of pork. The 12-month provision in this amendment would create a definite tendency to reverse this trend."

I quote section 306, "Sales of Livestock", of H. R. 4473, as follows:

"Effective with respect to taxable years beginning after December 31, 1950, section 117 (j) (1) is hereby amended by adding at the end thereof the following new sentence: 'Such term also includes livestock held by the taxpayer for draft, breeding, or dairy purposes for 12 months or more'."

This is the bill as it now stands in the Senate Finance Committee.

The Beef Cattle and Wool Growers Association have made the following suggested improvement in the above paragraph, as follows:

"SEC. 306. SALES OF LIVESTOCK.

"Section 117 (j) (1) is hereby amended by adding at the end thereof the following new sentence: 'Such term also includes livestock, *regardless of age*, held by the taxpayer for draft, breeding or dairy purposes, and held by him for twelve months or more *from the date of acquisition*.' The amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from six to twelve months shall be applicable to taxable years beginning after December 31, 1950."

We concur in the recommendations of the changes submitted by the beef and wool people and take exception to only one provision. We recommend that the words "twelve months" be changed to "eight months" for the following reasons:

1. Any gilt or sow will normally farrow, raise and wean two litters of pigs in a period of 8 months. By that time she will be either a proven producer or definitely unprofitable for various reasons such as (a) size of litter, (b) milking qualities, (c) size and strength of pigs, (d) general growth of litter. (e) blemish on sow or disease.

If, for any, or several, of these reasons she should be culled, while she will have approximately doubled in value (which constitutes a capital gain) yet for efficient pork production she should be sold at once. Under the 12-month provision, as it now stands, a farmer would be required to carry a sow an additional 4 months, after weaning her second litter, in a barren condition or rebreed her. Thus, even though she was a poor producer, she would have to be carried up to farrowing time for a third litter before the 12-month period was up and probably produce a third unprofitable or questionable litter.

2. On the other hand, 8 months will furnish an incentive to cull closely (as is recommended by all colleges, breed associations and the Department of Agriculture), thus creating more pork and more net profit to individual producers who follow these good practices.

3. If you increase the net profits of individual hog farmers by efficiency then you automatically increase the tax revenue.

Thus, this recommendation, if followed, will:

1. Increase the efficiency of feed grains converted into pork.
2. Increase ultimately the tax revenue.

We, therefore, recommend that this change be made or that a law be passed to increase the gestation period of brood sows from 4 to 8 months.

To the Chairman and Members of the Finance Committee:

In behalf of the members of Local 589, UAW-CIO and the employees of Ronson Art Metal Works, Inc., located in Newark, N. J., and Stroudsburg, Pa., I wish to appeal to you to reconsider deleting the Retail Excise Tax Act, section 431, from the Revenue Act of 1951.

If this act is enacted and the excise tax is put on lighters, it will have a great effect upon our working people; whereby if the sales of the lighter industry drop, it means that many of our workers will be laid off. We cannot afford a lay-off, particularly in our plant, as there are many elderly workers who will be unable to secure employment in other plants because of their age.

I have been employed by the Ronson Co. for the past 24 years, and through experience I know that if the sales drop as they did in 1931, 1932, and 1933, we will again have to work 3 days a week and many employees will be laid off.

There are many lighters which are brought in from Europe and especially Japan, that are favored by the low tariff rates and low wages, and if this condition of importing foreign lighters into this great Nation of America continues, our citizens will be deprived of employment because of the great competition. There has also been a reduction in the tariff rates on lighters coming in from Austria. We already have reduced the working hours in the plant because of restricted Government orders on the use of critical materials.

I, therefore, now, in behalf of our workers, not only in the Ronson Co. but in all the lighter industry, appeal to the Finance Committee to reconsider the 20-percent retail excise tax and delete it from the Revenue Act of 1951.

I want to thank the committee for any consideration they may show to the workers of America.

JOSEPH A. DIMODICA, Jr.,
President, Local 589, UAW-CIO.

STATEMENT OF JOSEPH J. PUGH, ATTORNEY, NEW YORK CITY, ON BEHALF OF CORPORATE DEALERS IN MUNICIPAL BONDS

This statement is submitted on behalf of Adams, McEntee & Co., Inc.; Andrews & Wells, Inc.; Eldredge & Co., Inc.; George B. Gibbons & Co., Inc.; King, Quirk & Co., Inc.; W. H. Morton & Co., Inc.; Roosevelt & Cross, Inc.; and Chas. E. Weigold & Co., Inc.; all of New York City. These corporations are municipal bond dealers, i. e., they are in the business of purchasing municipal and other tax-exempt bonds and reselling them to their customers. Profits from their operations are, of course, subject to all corporate taxes, including excess-profits taxes. Because of a technical error in the Excess Profits Tax Act of 1950, municipal-bond dealers are effectively deprived of the use of the invested capital credit and, if the dealer was incorporated after 1945, it is deprived of the use of both the invested capital and the income credit.

The technical defect which results in the denial of excess profits credits to municipal bond dealers arises from the exclusion from their assets under the Excess Profits Tax Act of 1950 of all so-called tax-exempt securities. The treatment of tax-exempt securities as inadmissible assets is obviously correct for those taxpayers whose income from tax-exempt securities is not subject to excess profits tax. Municipal bond dealers, however, derive their income principally from sales of municipal bonds, which are not capital assets, and such income is fully subjected to excess profits taxation. Since inventories of municipal bonds frequently represent more than 90 percent of a municipal bond dealer's total assets, it is necessary to treat such securities as admissible rather than inadmissible assets in order to give these taxpayers any credit for excess profits tax purposes.

Municipal bond dealers, like all other taxpayers, should be subjected to excess profits tax only in respect of their excess profits, as determined under either the invested capital method or the income method. Where corporate stocks represent inventories in the hands of stock dealers, an exception to the general rule that corporate stocks are inadmissible assets appears in both the former excess profits tax law and in the 1950 act. There is no logical reason why municipal bonds held by dealers for sale to customers should not also be includible as admissible assets for the purpose of determining excess profits taxes.

Denial to municipal bond dealers of the use of their invested capital for excess profits tax purposes under the 1950 act seems to have been wholly unintentional. Under section 720 (d) of the former excess profits tax law, municipal bonds could be included in the invested capital of any taxpayer, provided the taxpayer agreed to include the income from the municipal bonds in taxable income. Under the former excess profits tax law, therefore, the municipal bond dealers had no problem. However, this provision was omitted from its corresponding section 440 of the 1950 act, because of the fact that the 12 percent credit on invested capital far exceeded any return on municipal bonds. The fact that the principal source of the municipal bond dealer's income is profits from dealing in the bonds, which profits are fully subjected to excess profits taxation, appears to have been overlooked.

Attached hereto is a suggested amendment to the Excess Profits Tax Act of 1950 which it is believed will adequately cure the defect here complained of. Inquiries directed to the joint committee, the Treasury Department, and the Bureau of Internal Revenue indicate no opposition to the retroactive adoption of such an amendment.

Draft of Amendments to Excess Profits Tax Law Relating to Inadmissible Assets of Municipal Bond Dealers

Add a new section 433 (a) (1) (R):

(R) Interest on certain government obligations.—If the taxpayer has for such year made the election provided for in section 440 (c), there shall be included an amount equal to the amount of interest on obligations held during the taxable year which are described in section 22 (b) (4), any part of the interest from which is excludible from gross income or allowable as a credit against net income, and which are not capital assets, reduced by the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23 (b) and by the amount of the bond premium, amortizable under section 125, attributable to such obligations."

Add a new section 433 (b) (16):

"(16) Interest on certain government obligations.— If the taxpayer has for any taxable year with respect to which the tax imposed by this subchapter is applicable, made the election provided for in section 440 (c), there shall be included in determining the average base period net income applicable to such taxable year, an amount equal to the amount of interest on obligations held during the taxable year which are described in section 22 (b) (4), any part of the interest from which is excludible from gross income or allowable as a credit against net income, and which are not capital assets, reduced by the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23 (b) and by the amount of the bond premium, amortizable under section 125, attributable to such obligations."

Add a new section 440 (c):

"(c) Treatment of government obligations as admissible assets.—The taxpayer may in its return for any taxable year elect to increase its excess profits net income for such taxable year by an amount equal to the amount of the interest on all obligations held during the taxable year which are described in section 22 (b) (4), any part of the interest from which is excludible from gross income or allowable as a credit against the net income, and which are not capital assets, reduced by the amount of interest paid or accrued during such year which is not allowed as a deduction under section 23 (b) and by the amount of the bond premium, amortizable under section 125, attributable to such obligations. If the taxpayer so elects, the term 'admissible assets' includes such obligations, and the term 'inadmissible assets' does not include such obligations, for the purpose of all determinations (including determinations relating to other taxable years) in connection with the computation of the tax imposed by this subchapter for such taxable year."

Statement of G. W. Hornsby, Chairman Committee on Taxation, Trust Division, Pennsylvania Bankers Association

The revenue bill of 1951 (H. R. 4473) includes a provision for a 20-percent withholding tax on dividends and interest.

At the convention of the Pennsylvania Bankers Association held at Atlantic City, June 5, 1951, the trust division passed a resolution to express its opposition to the proposed withholding. The following reasons are given to substantiate the opposition:

1. In Facts and Figures on Government Finance published by the Tax Foundation, it is stated that for the year 1947 dividends amounting to $8,365,202,000 were paid by corporations. The House Ways and Means Committee in its report dated June 18, 1951, estimates underreporting of dividends will be $1,100,000,000 for the year 1951. It seems incredible that such a large percentage of dividends escape taxation. It would appear that a large portion of the un-

reported dividends belong to individuals who by reason of their exemptions owe no tax and to charitable, religious, educational, etc., organizations which are not liable for tax.

2. Those persons with small incomes (mostly individuals past 65 years of age) who owe no tax would be penalized by having 20 percent of their income improperly withheld from them and would be compelled to wait a year to obtain a refund. With the present high cost of living this would impose a severe hardship on many of these persons. In many cases through inability to comprehend the law the tax withheld would never be recovered.

3. Exempt charitable, etc., organizations would also be penalized by being unnecessarily and improperly deprived of 20 percent of their income from trusts and investments. Under H. R. 4473 these organizations would be permitted to recover a portion of this amount during the year by taking credit for the improper income tax withholding against any liability for income and social security tax withheld from salaries of employees. In many cases, however, this would absorb only a small portion of the income tax primoperly withheld and the organization would be required to file claims quarterly to obtain a refund of the excess withholding. This could result in a restriction of activities on the part of many charitable, religious, educational, etc., organizations to the detriment of the public welfare.

4. Nonresident alien beneficiaries of trust accounts would suffer a 20-percent reduction of income despite the fact that by reason of treaties their tax rate might be considerably less than this (i. e., Canada, 15 percent; United Kingdom, interest, 0 percent; dividends, 15 percent). It could be said that the withholding of an excessive amount of tax which, presumably could not be recovered without a complicated procedure at some later date, actually constitutes a violation of the treaty. In many cases the nonresident alien beneficiary of the trust would be only one of a number of beneficiaries, the others being residents of the United States.

5. The same situation would arise in cases where securities owned by a nonresident alien are registered in the name of a nominee residing in the United States. The paying companies would probably insist on withholding the 20-percent tax to protect themselves.

6. It is proposed that the payor will remit the amounts withheld to the Bureau of Internal Revenue but the payor will not be required to report the amount withheld for each individual or to furnish receipts to such individuals. If this method is used the Bureau of Internal Revenue could not properly certify as to the amount of the credit or refund and as all types of dividends and interest are not covered under the bill the taxpayer would have no way of proving the proper withholding on the return.

7. In addition to the enormous cost to the Government of processing the credits and refunds of this withholding tax, all trustees would be forced to maintain additional records at tremendous cost in order to be able to advise each trust beneficiary of the amount of credit for tax withheld which each beneficiary would be able to claim as a credit in his individual return.

Senator HOEY. The committee will take a recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:45 p. m., the committee recessed to reconvene at 10 a. m., Friday morning, July 27, 1951.)

REVENUE ACT OF 1951

FRIDAY, JULY 27, 1951

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

The committee met, pursuant to recess, at 10 a. m. in room 312, Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd (presiding), Hoey, Kerr, Millikin, Taft, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff; and Russell M. Oran, Joint Committee on Internal Revenue Taxation.

Senator BYRD. Let the meeting come to order.

Mr. Fred Morrison. Mr. Morrison, you have been assigned 10 minutes.

STATEMENT OF FRED W. MORRISON, NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

Mr. MORRISON. All right, sir. My name is Fred Morrison, and I live in Washington.

Senator BYRD. Go ahead.

Mr. MORRISON. Mr. Chairman, and members of the committee, my name is Fred Morrison. I appear before you on behalf of the National Association of Investment Companies. The member companies of this association are practically all of the registered investment companies in the United States.

Regulated investment companies are registered with the Securities and Exchange Commission and their shares are publicly held.

They have a diversified list of investments, in stocks and bonds, and they are subject to the tax provisions of supplement Q of the Internal Revenue Code.

They obtain their investment capital from the public sale of their shares and then invest their funds primarily in stocks and bonds of other companies.

They give to the investor the opportunity to combine his funds with those of others in order to obtain diversification of risk and experienced investment management, which he might not on his own otherwise be able to get. These companies have total assets of more than $3 billion, yet the average holdings of the average investor in them is under $3,000. They are, to a large extent, the little man's investment medium.

In order to place persons who invest through a regulated investment company as nearly as possible in the same position taxwise as persons who invest directly in the securities of the underlying companies that the investment companies invest in, supplement Q—sections 361 and 362—contains special tax provisions applicable to these companies and their shareholders.

This method of taxation was begun 15 years ago. It provides that if the regulated investment company distributes to its shareholders at least 90 percent of its ordinary income, that is, its income other than capital-gains income, the company then pays income tax only on any income which it does not distribute—only on the undistributed part of that income. In practice, the companies distribute all their ordinary income and the shareholders pay the tax on it when it is distributed to them as ordinary income to them.

Senator TAFT. It is kind of a cooperative investment company.

Mr. MORRISON. Hoping to get better brains than you have got yourself, yes, sir; yes, Senator. I am speaking from the point of view of the shareholders.

Long-term capital gains realized by the investment company, if retained by it, are taxed at the regular corporate capital-gains rate, presently 25 percent.

To the extent that the gains are currently distributed, the company pays no tax on them, but the shareholders include them in their individual tax returns as long-term capital gains and, therefore, shareholders pay that capital-gains tax.

The plan has worked well. However, recent experience shows that in one important respect the plan could be substantially improved, we think, and without any loss of revenue.

The problem arises out of this fact: the present law has the effect of forcing distribution of all realized capital gains. This occurs because under the existing law such gains, if retained by the company, would incur a 25-percent tax, a rate which is higher than the effective rate of tax which the large majority of shareholders themselves pay when the capital gains are distributed to them.

In addition, if the gains are retained by the company, the shareholder would have to pay an additional capital-gains tax with respect to such gains when he later sold his investment company stock, since being retained they would be reflected in the selling price of the stock, when he finally sells the stock.

The present practical necessity of distributing all capital gains tends to influence the investment company's policy, and it can have an adverse effect on the interest of their stockholders.

I think that is demonstrable. If a regulated company has large unrealized appreciation in its investments, substantial changes in its portfolio, that is selling one kind of security in order to put the investment into another—substantial changes in the portfolio deemed desirable by the management in the exercise of its best judgment may well have the effect of realizing a very large amount of capital gains.

As a practical matter, under existing law, these gains must be paid out to stockholders, and they must, therefore, become unavailable for reinvestment for their benefit.

A stockholder purchasing and holding shares of an investment company wishes to have his capital managed for him by that company and not in substantial measure returned to him. The management ought not to have to take into account the fact that capital gains, if unrealized, may be retained in the investment fund and are retained in the investment fund, but, as soon as realized, must be distributed to shareholders.

This problem has become particularly acute now because security values have risen over a pretty long period and there is a large amount of appreciation in the investment portfolios of these companies.

Senator TAFT. Can't you sell the stockholders the theory that they should reinvest these capital gains with you?

Mr. MORRISON. They do that to the best they can. I am coming to a little more direct discussion of that right now, Senator.

Senator TAFT. Your case almost looks to me like the farm cooperatives, I do not see much difference. They want to keep the surplus by issuing scrip certificates, pay no tax, and you want to keep the surplus——

Mr. MORRISON. And pay the tax. There is the one important difference, Senator. If they want to keep it without paying the tax, these companies wish to keep it and pay the tax.

Senator TAFT. Capital-gains tax?

Mr. MORRISON. Yes; and they do pay, their shareholders do pay, all the tax on their ordinary income, too, sir.

Senator WILLIAMS. Can't you keep it under the existing law if you pay your capital-gains tax?

Mr. MORRISON. Yes. But under the existing law if you distribute it, the company does not pay the capital-gains tax, the shareholder does. Under the existing law if the company retains it, it pays the capital-gains tax, and then when the shareholder sells his share in that company, if the company has been wisely managed and there is appreciation in its stock, he pays that tax over again.

Senator TAFT. Now you are suggesting that you do not want to pay the tax. You want to keep that surplus without paying the tax.

Mr. MORRISON. Oh, sir, keep it and pay the tax.

Senator TAFT. You can do that now.

Senator MILLIKIN. Let us hear his scheme; let us see what he has got.

Senator TAFT. All right.

Mr. MORRISON. Some of the open-end investment companies, that is, those companies which are under a legal obligation to buy back from the shareholders their stock, the shareholder's stock, at any time at approximately the current asset value of the stock, some of these open-end companies have endeavored to meet this troublesome problem by paying optional stock dividends to the extent of their long-term capital gains.

Under this optional stock dividend procedure, the stockholder receives a stock dividend unless within a specified time he makes a written election to take the cash equivalent.

These distributions, whether the shareholder elects to take cash or the stock, are taxable to him, to the shareholder, as long-term capital gains under section 115 (f) (2) of the code.

However, for a company having a large number of shareholders, the optional stock dividend method is cumbersome, is expensive, is unsatisfactory. Furthermore, closed-end investment companies, that is, investment companies which do not regularly buy back their shares from their stockholders, for various reasons, do not find it feasible to use the optional dividend method.

Senator MILLIKIN. Are these companies common-law trusts or corporations? Are they so-called Massachusetts-type trusts?

Mr. MORRISON. I think they are corporations—some, I think most.

Senator MILLIKIN. They are both?

Mr. MORRISON. I think that is right. I think they are not mostly Massachusetts-type trusts.

Therefore, the regulated investment companies respectfully request that the statute be amended so that the income tax results to the investment companies and their shareholders with respect to long-term capital gains will be the same whether such gains are distributed to the shareholders or retained by the companies.

They propose that this be done in the following manner:

(1) To meet the problem of the open-end companies—that on any day will buy back from me what investment I have in it, at the asset value of my stock in it—to meet the problem of the open-end companies by amending the statute to provide that where capital-gain dividends are distributed in the form of a stock dividend which the shareholder can redeem at any time for approximately its asset value, such a dividend shall be treated as taxable to the shareholder in the same manner as the present practice, as the optional stock dividend is now taxed to him under section 115 (f) (2) of the code.

Such a stock dividend is essentially the same as an optional stock dividend since immediately upon receipt of the stock the shareholder has the right to turn it into the company for cash at its asset value.

He can turn it in—he can turn in any other shares that he has in that company, any time he wishes for their asset value. That is one.

Senator MILLIKIN. You operate under a very widespread discount, do you not?

Mr. MORRISON. It varies, I think, Senator.

Senator MILLIKIN. It is rather wide; it is 6, 7 percent in many cases, is it not?

Mr. MORRISON. I am not good enough to differ with you, but I think that the discount is much less than that. The turn-in price is at its current asset value. I am not positive. I can ask, and I can tell you that in a moment.

The second amendment proposes to meet the problem of the closed-end companies by requiring a corporation, as at present, to pay over to the Treasury a 25-percent tax on long-term capital gains which the company retains, and by amendment of the code to require each person who is a stockholder in that company at the close of the taxable year to include in his return his share of the company's net long-term capital gains retained by the company, so retained, and to permit him, the shareholder, to take credit in his return for the 25-percent tax paid over by the company, and to increase the basis for his stock so as to reflect his share of the balance of the realized capital gains remaining in the company after the payment of the tax on it thereon.

Now, under these amendments the Treasury would collect the same taxes on realized capital gains of these companies, whether distributed or retained by them, as it now collects on gains which are distributed, and presently all gains almost always are distributed.

Since practically all capital gains are now distributed by the companies to the shareholders, the amendment would not result in loss of revenue. The only practical change would be this: That realized capital gains instead of having to be distributed currently in their entirety to shareholders as dividends, could be treained in whole or in part should such retention be deemed to be in the interest of the shareholders.

Senator WILLIAMS. When you distribute that now in cash to those shareholders, it is taxable to them as straight income.

Mr. MORRISON. A closed-end company, Lehman Corp., and others, they distribute their ordinary income and their long-term capital gains both in cash.

An open-end company that has the duty, when a shareholder asks it to do it, to redeem his stock in it at its asset value, it gives presently—most of them give presently—to their shareholders the choice on a long-term capital gain dividend to take it in cash or to take it in stock of the investment company.

Senator WILLIAMS. But the question is, when they take it in cash, it is taxable at the regular income-tax rates?

Mr. MORRISON. And when they take it in cash or in stock in the company it is taxable to the shareholder at the capital-gains rates.

Senator MILLIKIN. I suggest to you that a part of the problem involved is the legal relationship between the company and the stockholder or between the trustee and the beneficiary, and without going into it now and delaying this hearing by going into it, I believe it would be a good thing for you to add a supplemental memorandum stating which companies are corporations and which companies are—I call them—common-law trusts.

Mr. MORRISON. Yes, sir.

We will be pleased to do it.

Senator MILLIKIN. Because the legal relationship is somewhat different.

Mr. MORRISON. Yes, sir.

(The following memorandum was subsequently supplied for the record:)

MEMORANDUM SUPPLEMENTAL TO TESTIMONY OF FRED W. MORRISON

On July 27, 1951, Fred W. Morrison appeared before the Senate Finance Committee on behalf of the National Association of Investment Companies in support of proposed amendments to the Internal Revenue Code regarding capital gains realized by regulated investment companies.

At the hearings Senator Milliken inquired as to the number of regulated investment companies which are organized as corporations and the number which under State law are trusts. It was agreed that a mamorandum would be filed with the committee setting forth this information

The National Association of Investment Companies has in its membership 121 regulated investment companies, constituting substantially all the regulated investment companies in this country. Of the 121 companies, 102 companies are organized as corporations under the State laws (including one which is a joint-stock association) and 19 are trusts.

The legal status of the organization as a corporation or a trust under the State law has no effect upon the Federal income tax of the organization or of the shareholders or beneficiaries. This is because under section 3707 of the Internal Revenue Code the term "corporation" is defined to include an "association" and the term "shareholder" is defined to include "a member in an association." It has been well settled for many years under the regulations of the Treasury Department and court decisions that those investment companies which are organized as trusts under State laws constitute "associations" for Federal tax purposes and are taxable in the same manner as corporations. Furthermore, the holders of trust certificates are taxed in the same manner as shareholders of incorporated investment companies.

Accordingly, the amendments which were requested on behalf of the regulated investment companies at the hearings on July 27, 1951, would apply in the same manner and with the same effect whether they are organized as corporations or trusts under State law.

Senator TAFT. Mr. Morrison——

Mr. MORRISON. Yes, sir.

Senator TAFT. I think your plea is very logical, but do you not think it is much like what the farm cooperatives are trying to do? I cannot see any difference. In effect, you relieve the company of a tax on an accumulated surplus——

Mr. MORRISON. No, sir——

Senator TAFT (continuing). And pass the tax instead of that—substituting for that a lower tax for those stockholders who have a lower income where they do not get up to the 25 percent limit.

Mr. MORRISON. Senator, I do not believe I am saying that, sir.

Senator TAFT. You say you want them to require each person who is a stockholder at the close of the taxable year to include in his return his share of the company's net long-term capital gains so determined, and permit him to take credit on his return for the 25-percent tax paid by the company. In other words, the company pays it, and he gets it back if he has a less tax, when he pays his tax. The only tax paid on that capital gain is what he pays, and he can pay on that as ordinary income, and that will save him 10 percent at the ordinary rate instead of the 25-percent rate; is that not correct? Is that not what you want?

Mr. MORRISON. He has got that now, sir.

Senator TAFT. Is that not what you are asking for? Is that not what you are asking us to do?

Mr. MORRISON. No, sir.

Senator TAFT. Well, I cannot understand what you are asking then. Today, as I understand it, you pay a 25-percent tax on money retained on a capital gain, on money retained by you, and not distributed to the stockholders.

And the stockholders——

Mr. MORRISON. Senator Taft, that is hardly ever done.

Senator TAFT. I am not saying that it is done, but that is the effect, if you do it.

Mr. MORRISON. If you do it.

Senator TAFT. Yes, sir.

Mr. MORRISON. Yes.

Senator TAFT. You say that we want to be able to retain that, with the net result that the only tax paid on that capital gain is what is paid by the stockholders.

I think it is logical enough, assuming you are a cooperative investment company. I think that it is not unreasonable. I only say it is exactly what the farm cooperatives are asking us to do with respect to the distribution of stock representing retained surplus.

Senator MILLIKIN. That should not "discombobulate" you, because we have not determined that what the farm cooperatives are asking is either right or wrong.

Senator TAFT. No, but I am interested in the theory of what you are asking us to do.

Mr. MORRISON. I am a little hesitant—and this is said most respectfully—to debate this with you, but I do not think that I am saying——

Senator TAFT. I may misunderstand your proposal and that, I think, is important that we get it clear. What do you propose to do with retained surplus, the proceeds of capital gains?

Senator MILLIKIN. What do you propose that is different from what you are doing now?

Mr. MORRISON. I would like to see if I can say that to you.

Senator TAFT. Yes.

Mr. MORRISON. The way it works now on long-term capital gains is this: A company has a million dollars of long-term capital gains realized in this taxable year.

It distributes that million dollars to its shareholders. I say I have stock in the company whereby I get a $100 long-term capital-gain dividend from the company. I pay a tax on that. The company pays no tax ahead of me on it. That is the present plan.

Senator TAFT. That is right.

Mr. MORRISON. If my income rate is——

Senator TAFT. However, if the company—let us assume that the company does not distribute the million dollars.

Mr. MORRISON. That is what I am coming to.

Senator TAFT. Suppose they only distribute three-fourths of it, and keep $250,000, what do you pay now on that?

Mr. MORRISON. Well, the company would be in a terribly uncompetitive position if it kept it presently and paid a 25 percent capital-gains tax on it, you see.

Mr. STAM. It pays a capital gains-tax on it.

Mr. MORRISON. Then, when the individual gets it directly or indirectly, he pays another one, so that is a burdensome way for a company to operate today, sir. They pay out, in effect, on their long-term capital gains.

Senator MILLIKIN. What you are saying is that under the postulate of Senator Taft there would be a double capital gains, one by the company and one by the——

Mr. MORRISON. Yes, sir.

Senator MILLIKIN. Yes.

Senator TAFT. You pointed that out in your statement.

Mr. MORRISON. Now, the difference between the present plan and what I am asking for——

Senator MILLIKIN. What do you propose?

Mr. MORRISON. I would like to tell you and see if I cannot say it correctly. Instead of the million dollars in long-term capital gains being paid out by the investment trust, it retains it, and pays $250,000 of long-term capital gains tax on it, 25 percent. It sends me a notice that the amount of long-term capital gains from it, which I do not get but which I must pay tax on, is $100, setting me up as $100-dividend man out of this company this year, and it says, "We have paid for you $25 of that tax."

So the Government, the Treasury, collects in this retained capital gains 25 percent in the year in which the gains are realized. Under the present plan he gets 25 percent from me if I have enough income to be in the 25 percent long-term capital gains bracket.

Senator TAFT. You said if you were in the capital gains bracket. You said most of these stockholders were small stockholders paying less than 25 percent.

Mr. MORRISON. Yes, sir.

Senator TAFT. Then, in that case the Government gives up on that $250,000 you pay, in the refunds for the stockholder who, we will say, has to pay 15 percent, he can then charge himself with a tax of 15 percent, and he takes a credit for 25 percent that you have paid for him. He gets that back, or he gets a reduction in his general tax, so that the net result is that the only tax paid on that capital gain is the net tax paid by the stockholders, is that not correct. The company kind of collects at the source for the Government but, roughly speaking, the tax paid is the tax paid by the stockholder.

Mr. MORRISON. And that is the only tax that the Government now gets, too, sir.

Senator TAFT. Yes; I do not say that it does not.

Mr. MORRISON. Yes, sir.

Senator TAFT. The Government would get more than that if you kept it as it is today.

Mr. MORRISON. Oh, yes; but you could not run one of these companies for a long time and keep on keeping it without your competitors working on you, I think.

Senator TAFT. You want to keep the surplus that you have earned, and not have the company paying any tax on it, but the stockholders paying the tax on it, in effect, that surplus?

Mr. MORRISON. And giving a credit for it.

Senator TAFT. In effect, the surplus is assigned to them, and increases the value of their stock, and they pay a tax on the net capital gain presented by that increase. That is about what happens. I say personally I do not see why it is not exactly what the farm cooperatives are asking us to do in another field but I do not——

Senator MILLIKIN. Well, the surface difference is that these gentlemen propose to pay the tax in the first instance at the corporate level.

Senator TAFT. At the source.

Senator MILLIKIN. Which is something the cooperatives do not propose to do.

Senator TAFT. It might be a good thing for the co-ops to do.

Senator MILLIKIN. If they do, there is a dinstinction there.

Senator WILLIAMS. If I understand it, there is a lot of similarity between your proposal and that of the cooperatives but there is this difference: You are speaking about how it would affect a man who draws a $100 dividend from the corporation. Take a man who draws a $100,000 dividend, and we do have such men, if that goes through that distribution would be taxable at the capital gains rate of 25 percent, whereas at the present rate it would be taxable at the existing rate of $60,000 or $70,000.

Mr. MORRISON. Oh, no, sir; it would be taxable at the same rate.

Senator WILLIAMS. Is it not taxable if you distribute a $100,000 dividend today as income?

Mr. MORRISON. No, sir; at the capital gains rate.

Senator TAFT. Capital gains.

Senator WILLIAMS. Does it take the capital gains rate, even the cash distribution by your company?

Mr. MORRISON. A company sends the taxpayer, the stockholder, two kinds of dividends a year if it has earned them. One is the ordinary dividend and interest income, ordinary income on which these shareholders pay at ordinary rates, the way you are talking to me about. The capital gains dividend goes to him as a long-term capital gain, and he pays on it the way he would pay—the man with the $100,000 income from it would pay 25 percent, sir. He could not get out of it under the law. I am sure I am right.

Senator WILLIAMS. I am like Senator Taft: I do not understand what you are trying to change.

Mr. MORRISON. I think if it would be possible for me to take a minute more I can, I think, say it a little clearer than I did. Here is a company which has General Motors stock, bought a long time back, and it has a substantial appreciation in it. Stock prices are higher than they were in 1938 and 1939, let us say. It wants to change that investment and wants to realize the long-term capital gains for it and its shareholders. It does it.

Then if half of the receipts from selling the stock should happen to be gain, that gain is turned back to its shareholders under the present law, all of it, and it is dissipated from the investment fund capital of the company; that is, the investment company.

Senator MILLIKIN. Now, what do you want to do?

Mr. MORRISON. I want the company to have the right to keep it and pay the tax on it in the year in which the capital gain is realized.

Mr. STAM. As I understand you, you want the tax to be paid by the corporation or by the trust or whatever you call it——

Mr. MORRISON. Yes.

Mr. STAM. At the 25 percent rate; but you want the stockholder to include in his income his proportionate part of that capital gain just as if it had been distributed to him, and let him get the credit for the tax paid by the corporation at the 25 percent rate; is that your proposition?

Mr. MORRISON. That is right.

Senator MILLIKIN. How do you work this when you are in a loss period? What happens when you are in a loss period?

Mr. MORRISON. When that period comes, unfortunately I think that this question is not very important then.

Senator MILLIKIN. Well, but you still have——

Mr. MORRISON. There is no carry-back or carry-forward.

Senator MILLIKIN. You still would have a distribution of losses. Will the absorption of the losses be at the corporate level, or will the losses be passed on so that the stockholder may avail himself of the losses?

How are you going to handle your losses?

Mr. MORRISON. At the corporate level.

Senator MILLIKIN. Corporate level?

Mr. MORRISON. Corporate level.

Senator TAFT. Does the stockholder get a realized loss when you do have a loss?

Mr. MORRISON. No, sir.

Senator TAFT. He gets no net. If you have a net loss on capital gains——

Mr. MORRISON. No, sir.

Senator TAFT. Or capital losses during the year, the stockholder does not get any deduction.

Mr. MORRISON. That is correct; that is correct.

Senator BYRD. Thank you very much, Mr. Morrison.

Mr. MORRISON. Thank you, sir.

Senator BYRD. Mr. Henry Bodman. You have been assigned 10 minutes, sir.

STATEMENT OF HENRY T. BODMAN, GENERAL VICE PRESIDENT, NATIONAL BANK OF DETROIT

Mr. BODMAN. Mr. Chairman and members of the committee, my name is Henry T. Bodman. I am a general vice president of the National Bank of Detroit, Detroit, Mich., and I welcome the opportunity to appear before the committee on what we regard as an extremely important subject; namely, the impact of the excess-profits tax law of 1950 on certain types of banks in the banking system.

I believe that the problem can be covered in the shortest possible time by reference to three or four charts that I have brought with me and which I hope all of you can see.

The upper line on that top chart—I hope you can read it——

Senator TAFT. It is the same in the book——

Mr. BODMAN. Well, they are almost the same.

The upper line on the top chart shows the growth in deposits of all member banks of the Federal Reserve System for the period 1935 to 1950, and you can see there has been a tremendous growth in deposit liabilities.

The deposits, as you can see, have increased from $38 billion in 1935 to about $130 billion at the end of 1950.

At the same time the capital of the banks has increased from about $5 billion in 1935 to something under $10 billion in 1950.

The fact of the matter is that the deposits in that period have had an increase of about 240 percent, while the capital accounts have increased by something under 90 percent.

Senator MILLIKIN. Since the advent of the Federal Reserve System and the guaranty of deposits, does the old-time relationship between capital and deposits continue to exist?

Mr. BODMAN. I think it has deteriorated and I think mainly in recent years because for the country as a whole we have had an increase of about three times in the total money supply, if you added the currency in circulation to the deposits.

Senator TAFT. You say here that each dollar is protected by 13 cents, whereas the 1935 amount was 7½ cents, so it is just cut in half.

Mr. BODMAN. The cushion is much less, but I think the question of Senator Millikin is whether we need as much cushion as we used to.

Senator MILLIKIN. That is the point.

Mr. BODMAN. I think at the moment it can be debated, but I think it is also clear that the thing has deteriorated to a great extent.

Senator BYRD. What is that when you said that there was three times as much currency?

Mr. BODMAN. What I said was that the total currency and bank deposits of the country are about three times what they were before the war.

Senator BYRD. 1940?

Mr. BODMAN. Yes, sir.

Senator MILLIKIN. Your point is that despite the fact that credit is easier to get, bank credit is easier to get, through the operation of the Reserve System, and that some of the old relationship, the protective relationship, has been weakened by the guaranty of deposits, nevertheless, in some parts of the banking structure at least, there is not a sufficient relationship between capital and deposits; is that the point?

Mr. BODMAN. That is correct; and, of course, the FDIC does not protect the capital anyway.

Senator MILLIKIN. I understand, but the capital is protected in part by the guaranty of deposits.

Mr. BODMAN. I think only the deposits are protected by the guaranty, not the capital.

Senator MILLIKIN. Yes.

Mr. BODMAN. I think the main point is that over this period——

Senator MILLIKIN. But am I incorrect in this: That if you guarantee the deposits, do you not less the risk on the capital?

Mr. BODMAN. No, I do not think so, sir, because if a bank gets into trouble through making poor loans and is unable to pay off its deposits, the FDIC will come in and, perhaps, pay off all depositors' accounts up to $10,000; but the capital of the bank will be wiped out in the process, and the FDIC will take that over.

Senator MILLIKIN. I am glad to have you make that point.

Mr. BODMAN. Yes, sir.

Well, in this period we have had an increase in the ratio of deposits to capital from about 7½ to 1 back in 1935 to about 14 to 1 today, which indicates that over this period the banking system has far less capital in relation to its deposit liabilities than it had in the past.

The State banking departments, the FDIC, the Comptroller of the Currency, and the Federal Reserve System have all been aware of the implications of this situation, and of the fact that many banks badly need additional capital.

As shown by the next chart, need for additional capital is particularly acute in certain types of banks in fast-growing communities.

The upper chart shows the increase in deposits from the year 1940 to 1950 for member banks in certain selected cities.

In New York City, for example, we can see that the increase has been over this period of the last 10 years of about 44 percent. For all Reserve cities it has been about 159 percent; for Cleveland about 162 percent; for Atlanta, about 161 percent; for Denver, 197 percent; and for Detroit, about 197 percent.

I might add that those figures do not quite agree with what is in the book on account of the book being prepared in February before final Federal Reserve figures were available.

The point is that the increase in these deposits shown on the very first chart have not been uniform throughout the country.

The banks in fast-growing communities in the Middle West and South and West have had tremendous increases in deposit liabilities without a commensurate increase in capital. The result is that the ratio of deposits to capital in the same cities varies tremendously.

For example, in New York the ratio of deposits to capital is about 11 to 1, which means that the deposits are something under 10 percent of the total capital structure—I should say that the capital is something under 10 percent of total deposits.

In all Reserve cities, as a whole, the ratio of deposits to capital is about 15 to 1—15½ to 1; in the city of Cleveland, which has had a rapid growth in business activity and in deposits, a ratio of about 18½ to 1; in Atlanta, a ratio of 19.3 to 1; in Denver, a ratio of 18.7 to 1, and in Detroit, a ratio of nearly 22 to 1, which means that we have less than $5 of capital in our bank for every dollar of deposit liability, and if we were not investing largely in United States Government bonds that might be conceived by some people to be an undesirable situation.

The bottom chart—we have just completed that chart. The problem to be considered is that bank deposits flow readily to areas of growing economic importance as production increases and as population increases, but bank capital does not move so freely.

The result is that capital is low in relation to deposits in such centers, as compared with the rest of the country. Now, what is the effect of the excess-profits tax on banks in communities where there has been growth in economic activity, and in the deposits, and where bank capital is needed?

It can be demonstrated, but I will not take the time to do so, that most banks with deposits of less than a hundred million dollars will be largely or wholly exempt from the excess-profits tax.

Out of 14,000 banks in the country, some 98 percent fall in this category and are largely or wholly exempt from the excess-profits tax.

This means that only 200 or perhaps 300 banks, representing about 2 percent of all the banks in the country, will bear the full burden of the tax.

A tax so discriminatory as to single out 2 percent to pay nearly all the tax would seem highly inequitable in its impact.

Senator BYRD. Have you made an estimate of the total of that tax that these two or three hundred banks would pay?

Mr. BODMAN. No, sir; we have not. We have not a reliable estimate. We know, however, that in the last war the largest amount of excess-profits tax paid by the banking system in any one year was in the year 1945, and the amount was $11,000,000.

Senator TAFT. Mr. Bodman——

Mr. BODMAN. Yes, sir.

Senator TAFT (continuing). On what basis do banks pay excess-profits taxes? Is it entirely based on capital or based on earnings, on base-period earnings?

Mr. BODMAN. As a practical matter, we believe that almost no banks are able to use the average-earnings approach on account of the shift in the character of their assets as between the base period and today. As a consequence, all banks, or virtually all banks, will have to use the invested-capital method.

Senator TAFT. And on that they are allowed how much as a base?

Mr. BODMAN. They are allowed 12 percent on the first $5 million of capital, 10 percent on the second $5 million, 8 percent on the balance, with an adjustment for inadmissible assets that tend to reduce the capital credit.

So that, for any bank which has any substantial proportion of its capital credit at 8 percent, after deducting approximately 50 percent normal and surtax, the bank can keep about 4-percent return on its capital, and that return——

Senator TAFT. What is that statement?

Mr. BODMAN. Well, if a bank is of a size category that a substantial part of its capital credit is figured at 8 percent—we know that it is 12, 10, and 8—but, if you assume a substantial part of it, everything over $10 million is figured at 8 percent, from that you must deduct the normal and surtax of 47 percent—in round figures we call it 50—that leaves the bank a 4-percent return on its capital structure, approximately speaking, which is a very low return when you consider that to raise new stock, to sell new stock in a bank, you must frequently pay 5-percent interest cost in terms of the dividends divided by market price; so that it is unprofitable for some banks to raise new capital if the dividend that they have to pay is equal to 5 percent of the market value, when they can only earn 4 on a substantial part of their capital.

Senator MILLIKIN. It works a dilution; does it not?

Mr. BODMAN. It works a very heavy dilution.

Senator MILLIKIN. So far as the older stockholders are concerned?

Mr. BODMAN. Yes, sir.

Senator TAFT. The bank in which I have stock in Cincinnati just sold it on a 4-percent basis, however, sir.

Mr. BODMAN. There are very few banks that are able to do that. I would be interested in that case to know whether the stock of the bank was not a very substantial discount from its book value.

Senator TAFT. No.

Mr. BODMAN. Most banks are, because the earnings are low.

Senator TAFT. I cannot answer that question.

Senator MILLIKIN. Is the corollary of what you say that the larger the capital the better the base for the purpose of excess-profits tax?

Mr. BODMAN. The larger the capital—no; I do not think that follows necessarily. The larger the capital, the larger the proportion on which the credit is only 8 percent; so that is a penalty in that sense to have a large capital.

On the other hand, I think another thing may be said, and that is that banks most in need of capital—that is to say, those that have the largest capital in relation to their deposits—feel it most.

Senator TAFT. What is it, 12 percent on the first $5 million?

Mr. BODMAN. Twelve percent. Ten percent on the next $5 million.

Senator TAFT. And 8 percent on the balance.

Mr. BODMAN. Eight on the balance.

Senator HOEY. It is true that most bank stocks sell below their book value currently on the market.

Mr. BODMAN. That is true, and I think the average might be 20-to-25-percent discount, and in some cases, 50 percent.

Senator HOEY. Yes, sir.

Mr. BODMAN. Because of the low earning power of banks under present conditions and, as I might add, very much lower if the excess-profits tax stays as is.

Senator BYRD. Are those earnings improving? The interest rates are getting higher.

Mr. BODMAN. The earning power, I think, would be improving were it not for the much heavier taxes, but I know of a good many banks that will have impaired earnings this year at the very time when they need new earnings to build up their capital to protect their deposit liabilities.

Senator TAFT. Is there any credit on Government bonds?—a considerable percentage of Government bonds enjoy a tax-free status.

Mr. BODMAN. Yes, sir.

That is the reason that banks are not able to go on the average-earnings basis. The point is that partially tax exempt Government bonds were the only type of Government bond outstanding prior to 1941; so the banking system, to the extent in the old days that it owned Government bonds, perforce owned partially tax exempt Government bonds, which were exempt from normal taxes.

In the base period, income from partially tax exempt Government bonds is not counted as part of your base earnings. In the same period the partially tax exempt Government bonds to a great extent have been called or have matured, and new fully taxable bonds have been issued in their place, and even if you assume the same earnings to stockholders after Federal taxes you will pay an excess-profits tax by virtue of the fact that you are not allowed to count the same income in the base year as you are taxed on in the excess-profits tax.

Senator TAFT. Can you make a statement about the amount of partially exempt bonds that still remain?

Mr. BODMAN. Yes, sir.

Senator TAFT. What is that?

Mr. BODMAN. It was a tremendous item in most banks.

The volume of partially tax exempt bonds outstanding in 1941 was about $32 billion or $33 billion.

Today there are outstanding under $10 billion. The percentage of earning assets of all banks belonging to the Federal Reserve System which were invested in partially tax exempt Government bonds was in 1940 about 30 percent, and now it is of the order of 7 percent; so that has been a big shift which no allowance is made for in the excess-profits tax.

Senator TAFT. And that 7 percent is disappearing gradually?

Mr. BODMAN. Yes, sir. So, it will be down to $3½ billion in 1955 and in another few years they are all gone.

The suggestion that we have to make will automatically correct that problem without actually making it very complicated.

The point that I was trying to get over to you gentlemen was that here you have a tax that hits two or three hundred banks, or 2 percent of all the banks in the country, and the remaining 98 percent pay little if any tax.

In addition, and of the utmost importance, is the fact that the tax will hit hardest those banks among these two or three hundred which are in rapidly growing communities, such as we have looked at here and which are most in need of additional capital.

This condition has further significance when it is recognized that some of the largest banks in the country, including some of the larger New York City banks will be exempt from the tax by virtue of their abundant capital.

Statements to that effect were made by the managements of certain of these banks, large New York City banks, at their stockholders' meetings last January.

The apparent solution to the problem of intermediate-size banks in fast-growing communities which are hardest hit by the excess-profits tax would seem to be the raising of additional capital.

This would improve the position of such banks and would reduce their excess-profits taxes.

But new capital can be raised in only two ways: One, through retained earnings; two, through the sale of additional stock.

You can see from this chart that where bank capital is most needed the highest percentages of earnings have been retained and reinvested in the business, and we show here again that in New York City, where bank capital is relatively abundant, that banks retained 45 percent of their earnings.

The banks in all reserve cities, taken as a whole, retain 56 percent.

In the Cleveland Federal Reserve District, they retain 61½, about the same figure for the Atlanta district, a little higher for the Kansas City district, and a substantially higher figure for the Chicago district, if you eliminate Chicago from the figures.

Senator HOEY. You mentioned these two methods of increasing capital. Could you increase it by stock dividends where the surplus or earned profits are sufficient?

Mr. BODMAN. It would not give you any more effective capital. It would change the form of capital from surplus to capital stock, but you would not give your depositors any more protection.

Senator HOEY. It does not give the depositors any more, but does it have any effect on the tax?

Mr. BODMAN. No; it does not have any effect because you are able to count your capital surplus and undivided profits and reserves.

The other method of obtaining capital is through the sale of stock—I am sorry. I read the wrong line.

What we have just shown here is that banks in localities where capital is thinnest try to retain the biggest percentage of their earnings to build up their capital.

However, the reinvestment of earnings is not a full solution. The real problem is that earnings are not sufficient to create new capital at an adequate rate even though dividends are held down.

The second method of obtaining new capital is to sell additional stock. The next chart shows that the price of bank stocks has been, as Senator Hoey was indicating, substantially below book values per share in most years since 1940.

This chart—I do not know whether you can read the numbers—covers the years from about 1938 to 1950, and the zero line is where the red stops, and below here [indicating] is minus. The other is plus, indicating that where these lines which indicate the ratio of market price to book value are below the zero line they are in the red, and the bank stocks are selling at a discount from book value; where they are in the black, they are above, and this chart shows that the price of bank stocks has been substantially below their book values per share in most years since 1940. This is because earnings are too low to justify a higher market price.

If additional stock is offered, it must be at a price below book value; that is, below the value of the bank in liquidation.

The stockholders, frequently the smaller ones, not in a position to make additional investments, will find their equity diluted where banks raise new capital through the sale of additional stock at a price below book value, which is the only price available.

If this problem is to be squarely faced, it must be admitted, first, that certain banks are badly in need of additional capital and, second, that if the necessary capital is to be obtained the banking system must be allowed to earn a return sufficient to create additional capital from retained earnings or to permit the raising of new capital through the sale of stock by presenting to the general public an invsetment which is competitive in the capital markets.

The next chart shows—to which I refer, the bottom chart here—that the return on bank capital has been relatively low. It shows that for a group of manufacturing concerns you have had returns running from 8 to 16 percent, whereas uniformly the returns on bank capital are substantially lower, of the order of 50 percent.

Senator TAFT. Would that not be necessarily so, just offhand?

After all, they have got their assets in Government bonds, most of them?

Mr. BODMAN. Yes, but they do not like to have it.

Senator TAFT. You have a much greater security today in banks than you had before?

Mr. BODMAN. I am not so certain, Senator.

Senator TAFT. I mean the return on bank stocks has always been below manufacturing companies, way below, in all history, so far as that is concerned.

Mr. BODMAN. I think that, perhaps, is true.

Senator TAFT. Perhaps not in 1929?

Mr. BODMAN. I think, perhaps, that is true.

At the same time, here we have a situation where the typical bank stocks of a good bank are selling at 25 percent below the value of the bank, if you close it up and lock the doors and sell off its assets.

Senator TAFT. Well, I have stock in a company, a manufacturing company, where the same thing is true, and worse, and it is, in fact, selling now at about 50 percent of its book value.

Mr. BODMAN. I do not believe that is generally true in manufacturing.

Senator TAFT. Well, maybe it is not, but it is true——

Mr. BODMAN. Well, that is unfortunate.

Senator TAFT. Those are about the only two things I own, one in bank stock, and one in a manufacturing company, and the manufacturing company is selling further below the asset value than the bank stock.

It is a small manufacturing company; it is not on the big board.

That kind of stock is very likely to be below book value.

Mr. BODMAN. I do not think it is very likely, by which I mean, if you take the average for all industry, manufacturing and all banking, you will find that the stocks of manufacturing industries sell at substantial premiums above book values, and in a good many cases several times book value; whereas, in banks they sell at substantial discounts almost uniformly.

Senator TAFT. What I wondered about was whether you are objecting to the fact that the tax is based on the fact that some banks earn a bigger return on their capital——

Mr. BODMAN. Than others; that is correct.

Senator TAFT. That they earn a bigger return on their capital than the 8 percent, and——

Mr. BODMAN. That is 8 percent before normal and surtax, of course.

Senator TAFT. But, of course, that in a way is the theory of this excess-profits tax, that the excess does not mean just Korea, the Korean War, because we have no possible means of relating it to the Korean War.

Mr. BODMAN. That is right.

Senator TAFT. That means that if you earn more than a certain amount on your capital, that is excess; in fact, the law itself goes down to 85 percent, which eliminates some of the theory.

Mr. BODMAN. Yes, sir; that is right.

Senator TAFT. And I wondered how the bank situation—I wondered whether there was a legitimate objection to the tax simply on the ground that because some banks earn a bigger return on capital, therefore, they should not be subject to the tax. That is the very theory of the tax; because they earn a bigger return on capital they should be taxed. I do not say it is a sound theory, but it is one of the theories at least.

Mr. BODMAN. It is one of the accepted theories, at least.

I think if the problem is to be looked at in the light of what is proper for the stockholders, that is one thing. But I think the real problem is what is proper for the industry. The important thing is not the stockholders in this case; the important thing is what is going to happen to the banking industry.

Here we have——

Senator TAFT. Well, is it not an important thing that 50 percent of your 8 percent is taken by the normal tax?

Mr. BODMAN. That is right, and surtax together.

Senator TAFT. Surtax. Is that not the important thing, rather than the excess-profits tax?

Mr. BODMAN. Which leaves you 4 percent.

Senator TAFT. That is the bad thing.

Mr. BODMAN. That is bad.

Senator TAFT. And the difficulty of raising new capital occurs in every business and in every industry simply because of the tremendous burden of this tax, of the corporation tax?

Mr. BODMAN. But other industries are able to raise new capital fairly readily.

Senator TAFT. Well, we have the complaint constantly that they are not. The big ones, yes—the big ones that are on the Board—but the small manufacturing company does not have any ability to raise capital.

It has great difficulty in raising capital because of this tax; I mean, that is the reason.

Mr. BODMAN. That is the problem.

Senator TAFT. There is no doubt about that. It seems to me an almost inevitable result of the present system of corporate taxation, but I wondered why the banks have any special claim to being different from anybody else.

Mr. BODMAN. Only because—and I do not think that we should think about the bank as such in terms of their stockholders—I think that we should think about it as an essential industry. I think the banks, as such, the banking system needs additional capital and some banks need additional capital infinitely more strongly than others do. As we can see, some banks have a ratio of as much as 10 percent of capital—I mean have 10 percent of their deposits represented by capital and others have 5 percent, and that is much too low.

Senator TAFT. Do you not think banks can finance? This bank in which I am a director has just financed, has just sold new stock, without difficulty, I think, mostly to stockholders.

Mr. BODMAN. I think in a great many cases that stockholders will realize later that they wished that they had not approved the additional sale of those stocks at those prices, and if they do they will vote against such additional stock sales, and they have the right to decide.

It is the private citizen who has the right to decide whether he is going to invest his capital in the banking industry or in some other industry, and I think the problem here is one of getting adequate capital in the banking industry.

Senator MILLIKIN. The element of regulation is important here.

Mr. BODMAN. It is a big factor.

Senator MILLIKIN. It has an effect on your business, which is not present in other businesses and draws a distinction between the two.

Mr. BODMAN. It is an important distinction.

Senator TAFT. Because you are in the class of utilities rather than in the other class?

Mr. BODMAN. That is the exact recommendation we are coming to, and if you will let me proceed I plan not to take any more of your time.

Senator TAFT. Sure.

Mr. BODMAN. Banking is an essential industry. The problem presented here is not basically one of affording relief for bank stockholders, but one of permitting the industry or certain segments of it to have sufficient earnings so that the essential functions of banking can be performed with adequate protective capital.

As stated recently by the New York State superintendent of banks, a State official:

> Banking is so closely entwined with the public interest that any undermining of its strength is of direct concern not merely to the owners of the banks but to the public generally.

Now, in our study of this problem we have considered various measures that might be adopted to correct the inequities which I have tried to describe.

We can see that it is particularly important to afford relief to banks which need additional capital and have had a rapid growth in line with their communities.

We also realize that any relief provided cannot be such as to give a windfall to other taxpayers not confronted with similar problems.

As an approach, we believe there are logical grounds for considering the banking industry as a regulated industry, which is what we have just been talking about.

The excess-profits-tax law gives special treatment to the airlines, the public utilities, and the railroads on the ground that they are regulated industries.

We, as banks, are regulated in that the price of our principal product, bank credit, has long been regulated through the control of the Federal interest rate.

The character and quality of bank assets are subject to regulation, and the amount of reserves which must be maintained in the form of nonearning assets is prescribed by appropriate Federal and State authorities.

There are other regulations, direct and indirect, too numerous to mention.

On the theory that we are a regulated industry, we propose, for any member of the industry who can qualify, that a relief provision be written into the law to provide a third alternative method of filing excess-profits-tax returns.

Briefly, we suggest that any bank which can prove, first, that it needed additional capital in the base period and, second, that it earned a certain minimum rate of return on its capital in the base period, that if both these two tests are met, the bank be permitted to earn after normal and surtax, a certain rate of return before being subject to excess-profits taxes.

Specifically, it is proposed that to qualify for the relief provision, the bank must be one which did not have in the base years, on the average, total capital funds and reserves exceeding 6 percent of its deposits, and it must be one which earned at least 7 percent on its capital funds and reserves in the base period.

For banks which can meet these two tests, it is proposed that they be permitted to earn, after normal and surtax, 7 percent on their invested capital before being subject to excess-profits taxes.

These tests are highly restrictive, and only banks badly in need of relief and badly in need of capital can qualify. In fact, I may say that there are a number of banks badly in need of capital who still could not qualify.

I should say that there are a number of banks, if I can correct that, there are a great number of banks, very hard hit by the excess-profits tax, who could not qualify under these two tests, and the tests, perhaps, are too rigorous.

The percentages suggested, of course, are to some extent arbitrary. However, the 6-percent ratio of capital to deposits seems reasonable, and not too high, in that it is less than the average for all banks, and is the minimum ratio which qualifies bank stocks as legal investments for savings banks in the State of Massachusetts.

Senator BYRD. To what extent would your proposal reduce the revenue, as provided for in the House bill? Do you have any estimate?

Mr. BODMAN. Senator, we have made an estimate of that which, necessarily, had to be done by statistical means, because the facts are not otherwise available, and the statistical method makes some assumptions.

Under our proposal, the highest amount of loss of revenue that we can conceive is about $20,000,000, but we think a more probable figure would be $10,000,000, but I would like to emphasize that we do not have great confidence in these estimates.

The percentages suggested, of course, to some extent, are arbitrary. The 6-percent ratio of capital to deposits seems reasonable and not too high; in fact, it may be too low in that it is less than the ratio for the average of all banks, and is the minimum ratio which qualifies bank stocks as legal investments for savings banks in the State of Massachusetts.

In other words, the Massachusetts law says that any bank which does not have at least 6 percent as much in capital as in deposits is undercapitalized and is not a proper investment for a savings bank.

The 7-percent minimum required rate of return on invested capital in the base years is suggested in order to prevent banks with low earnings in the base years from obtaining a windfall by being relieved of excess-profits taxes if their earnings increase in the excess-profits-tax years.

I would like, with your permission and at the invitation of the committee, to file and have made a part of the record two documents, one a memorandum dated July 5, 1951, giving the details of a proposed amendment to the Internal Revenue Code, which would correct the situation as we see it, or partially correct it, and, second, a brochure entitled "The Excess Profits Tax Act of 1950 and the Banking System," dated February 15, 1951, prepared by the National Bank of Detroit, and on which the charts I have shown you are based.

I would like to point out one thing, that in adopting this theory of regulated industry so that a bank would be permitted to earn a rate of return on its capital after normal and surtax, in our case, in which we are paying a very substantial excess-profits tax for 1951, that it would not have the effect of eliminating our excess-profits tax by any means.

It would reduce it by about one-third.

Thank you, Senator Byrd, and members of the committee.

Senator BYRD. Thank you, sir.

Senator TAFT. You say this would not eliminate all banks?

Mr. BODMAN. No, sir.

Senator TAFT. What kind of a bank would not be eliminated? You said only 2 percent of the banks were going to be——

Mr. BODMAN. Taxed.

Senator TAFT. Taxed now.

Mr. BODMAN. That is right.

Senator TAFT. This would reduce it to what percent?

Mr. BODMAN. I do not know, Senator. The restrictions that—if I can just go back one little bit—this proposal that we have made, obviously is patterned after what was done for the airlines and utilities, and we think there are logical grounds for doing that.

However, to qualify for that special provision two tests must be met:

You must show that you had too little capital in the base years, and that you earned a minimum rate of return in the base years on your capital, the latter idea being for the purpose of preventing a bank which only made 4 percent in the base years from making 7 percent in the excess-profits years.

It is to screen those out.

The other test, the requirement that a bank cannot have in the base period had more than 6 percent of its deposits in capital, is a highly restrictive test because there are not many banks whose capital structures are as thin as that.

If the committee believes that steps should be taken to induce or encourage more capital in certain other kinds of banks, that proposal could be eased up a little bit or, so far as we are concerned as a bank, the test could be eliminated altogether.

The only reason that we put in those qualifications was that it was indicated to us by some of our experts that the amendment, or the proposal would have no chance of adoption if it opened the door for all banks.

Senator WILLIAMS. What percentage of the corporations, generally, pay excess-profits taxes?

Mr. BODMAN. Senator, I do not know. I think it is a higher percentage.

Senator TAFT. Of all corporations?

Senator WILLIAMS. All corporations.

Senator MILLIKIN. Mr. Stam, what is that figure?

Mr. STAM. What is the percentage of over-all corporations?

Mr. ORAN. I do not have it exactly, but certainly there were about three or four hundred thousand returns, and I would say about 50,000 or about one-sixth.

Mr. STAM. My recollection is that the latest figures ran between forty and fifty thousand, I believe.

Senator BYRD. Thank you, Mr. Bodman.

Your documents which you have requested be inserted in the record at this hearing, will be inserted at this point.

(The memorandum dated July 5, 1951, and the report dated February 15, 1951, follow:)

ALTERNATIVE CREDIT—SUGGESTION FOR AMENDMENT OF THE EXCESS PROFITS TAX ACT OF 1950 TO PROVIDE MORE EQUITABLE TREATMENT FOR COMMERCIAL BANKS MEETING CERTAIN CONDITIONS

SUGGESTION

Provide a minimum excess-profits tax-credit for commercial banks, as an alternative to the average earnings credit and the invested capital credit.

PRECEDENT FOR RELIEF

A report prepared by National Bank of Detroit entitled "The Excess Profits Tax Act of 1950 and the Banking System" shows that the act has created inequitable results and hardship in the case of certain types of commercial banks. An exception to the general rules as they relate to commercial banks is clearly necessary. The provisions in the act relating to reserve for bad debts and FDIC assessments give appropriate relief in these areas but do not correct the specific inequity described herein.

Earning assets of banks, principally loans and investments, are provided to a large extent by deposits and vary directly with the volume of deposits. However, the deposit liability of a bank does not qualify as borrowed capital, and, therefore, such deposits are not included in any manner in the invested capital of banks. Where the ratio of equity capital to deposits is lower than the general average, the invested capital credit is clearly an inadequate standard of normal earnings.

Because of the decreasing amount of partially taxable Federal securities outstanding and in bank portfolios, the average earnings method is also an inadequate standard of normal earnings in the case of many banks. Under the act the starting point for determining excess-profits net income is the "normal tax net income" which represents net taxable income reduced by partially taxable interest. As a result, interest received on partially taxable Federal securities is completely excluded from excess-profits net income in each year in the base period as well as in the taxable year. Because of the decreasing amount of partially taxable Federal securities outstanding, a larger proportion of a typical bank's net income is excluded in the base period years than in an excess-profits-tax year.

Need for special treatment in some industries was recognized in the act. Section 448 provides a minimum excess-profits tax credit as an alternative to the average earnings credit and the invested capital credit for taxpayers in certain specified types of regulated industries. In general, such alternative credit assures such a taxpayer that an excess-profits tax will not be imposed until after it earns a net return after income tax (normal tax and surtax) equal to 6 or 7 percent of its invested capital. There is a basis for providing banks with similar special treatment, since the commercial banking industry is subject to strict regulation by Federal and State authorities.

PROPOSED REMEDY

Provide a formula for relief for those commercial banks which need the relief most, namely:

(1) Banks which during the base period had a lower than average ratio of equity capital to deposits; and

(2) Banks which characteristically earned during the base period a rate of return on equity capital at least as great as is proposed to be allowed as the minimum rate of return before an excess-profits tax is imposed.

It is proposed that a minimum excess-profits credit be made available to commercial banks which meet certain tests designed to establish that the bank is entitled to relief. This credit would be an alternative to the average earnings credit and the invested capital credit for such taxpayers.

In general, this minimum credit would consist of the corporate normal tax and surtax payable by the bank for the taxable year in question, plus 7 percent of the sum of the equity capital, retained earnings, and borrowed capital, less interest payable on the borrowed capital. Equity capital and retained earnings of the banks entitled to avail themselves of this alternative credit would be reduced proportionately by the so-called inadmissible assets, but for that purpose partially taxable Federal securities would be treated in the same manner as admissible assets.

It is proposed that this minimum credit be made generally available to commercial banks and trust companies, a substantial part of the business of which consists of receiving deposits and making loans and discounts, but that it be limited to those banks which meet two tests, namely, a maximum ratio of equity capital to deposits, and a minimum rate of return during the base period.

With respect to the deposit ratio test, it is proposed that this relief provision be limited to those banks which had a ratio of equity capital to total deposit liability of not more than 6 percent, which ratio would thereby be lower than the average ratio for banks generally during the base period. It is proposed that this test be applied as of December 31, 1949, the call date nearest to the close of the base period. In case a bank, merely because of a temporary fluctuation in deposit liability, might not meet the test on that date, an alternative test is proposed, namely, where the ratio of equity capital to total deposit liability on each of the call dates, on which reports of conditions of all national banks were required by the Comptroller of the Currency, during the base period, averaged not more than 6 percent.

In addition to the deposit ratio test, it is proposed that in order for a bank to be entitled to relief it must also demonstrate that its rate of return on equity capital was 7 percent or more in at least three of the taxable years in its base period or averaged 7 percent or more during the entire base period. Because of this test it is necessary to limit the relief to a bank which commenced business before the beginning of its base period. Inasmuch as borrowed capital is not a significant factor in the case of banks generally, the rate of return test during the base period should be measured by equity capital only

In computing the rate of return on equity capital it is proposed that net income in the base period years be increased or decreased by the adjustments required by section 433 (b) which are ordinarily applicable to banks. For this purpose net income in the base period years will include partially taxable interest.

Inasmuch as the amount of partially taxable Federal securities outstanding is decreasing and is being replaced by fully taxable securities to a large extent, it is proposed that for the purpose of this relief section the term "inadmissible assets" should not include partially taxable federal securities. Consistent therewith, it is necessary to treat the interest income from such partially taxable Federal securities as equivalent to excess-profits net income subject to excess-profits tax. This is proposed to be accomplished by reducing the alternative excess-profits credit by the amount of such partially taxable interest which is actually included in net income for the year in which the minimum credit is used.

PROPOSED AMENDMENT

SEC. 459. EXCESS PROFITS CREDIT—COMMERCIAL BANKS

(a) AMOUNT OF CREDIT.—In the case of a commercial bank (as defined in subsection (c)), the excess profits credit for any taxable year computed under this section shall be the sum of the tax imposed by sections 13, 14, 15, and 141 (c), for such taxable year and the amount determined under subsection (b).

(b) COMPUTATION.—The amount referred to in subsection (a) for any taxable year shall be determined as follows—

(1) by applying 7 per centum to the sum of the following:

(A) the adjusted invested capital for such taxable year, computed under section 437 (b) (2) without reduction by the amount of the net new capital addition and without regard to section 437 (b) (2) (C), and

(B) the average borrowed capital for such taxable year as defined in section 439.

(2) by reducing the amount ascertained under paragraph (1) by the deduction allowable for such year with respect to interest on indebtedness included in borrowed capital under section 439.

(3) by reducing the amount ascertained after adjustment under paragraph (2) by the amount computed under section 440 (b) (relating to inadmissible assets).

(4) by reducing the amount ascertained after adjustment under paragraph (3) by the amount allowable for such year as a credit under section 26 (a).

(c) TAXPAYERS TO WHICH SECTION APPLIES.—For the purposes of this subchapter the term "commerical bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions.

(1) A commercial bank (as defined in this subsection) shall be entitled to the benefits of this section if it commenced business before the beginning of its base period, and if—

(A) the ratio of its equity capital (as defined in section 437 (e), to its total deposit liability—

(i) on December 31, 1949, was not more than 6 per centum, or

(ii) on each of the call dates on which reports of condition of all national banks were required by the Comptroller of the Currency during the base period averaged not more than 6 per centum, and

(B) the rate of return on its equity capital (as defined in section 437 (e)).

(i) in at least three of the taxable years in its base period was 7 per centum or more, or

(ii) during the base period averaged 7 per centum or more.

(2) For the purpose of subsection (1) (B) the rate of return on equity capital shall be computed by determining the ratio of—

(A) net income for the taxable year reduced by the tax imposed by sections 13, 14, 15, and 141 (e) for such taxable year, to

(B) the adjusted invested capital for such taxable year computed under section 437 (b) (2) without reduction by the amount of the net new capital addition and without regard to section 437 (b) (2) (C), but reduced by the amount computed under section 440 (b) (relating to inadmissible assets).

(d) NET INCOME.—For the purposes of subsection (c) (2) (A) net income for any taxable year shall be the net income as defined in section 21 (a) as in effect for such taxable year, increased or decreased by the adjustments prescribed in paragraphs (1), (2), (6), (9), (12), and (13) of section 433 (b), and further increased by the deduction provided by section 23 (r) which shall not be allowed.

(e) INADMISSIBLE ASSETS.—For the purposes of subsections (b) (3) and (c) (2) (B), in computing the reduction to be made under section 440 (b), the term "inadmissible assets" means—

(1) Stock in corporations, except stock in a foreign personal holding company, and except stock which is not a capital asset; and

(2) Obligations described in section 22 (b) (4) the interest from which is wholly excludible from gross income.

* * * * * * *

SEC. 434. EXCESS PROFITS CREDIT—ALLOWANCE.

(e) SPECIAL RULE FOR COMERCIAL BANKS.—Notwithstanding subsection (a), in the case of a commercial bank (as defined in section 459) the excess-profits credit for any taxable year shall be an amount computed under section 435, section 436, or section 459, whichever results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed.

NOTE.—Additional provisions and cross references may be required to cover consolidated return requirements, acquiring corporations, etc.

THE EXCESS PROFITS TAX ACT OF 1950 AND THE BANKING SYSTEM

(Prepared by National Bank of Detroit)

INTRODUCTION

This report has been prepared in an effort to point up certain important effects on the banking system of the Excess Profits Tax Act of 1950. It does not deal with the merits or demerits of excess-profits taxes as such.

The report is concerned exclusively with certain circumstances surrounding the commercial banking business that make the application of the law inequitable and injurious to the banking system.

There are important differences between normal, everyday operations of a bank and the normal operations of most other types of business. Because the present excess-profits-tax law does not take effective account of these differences, it is believed that serious inequities, potentially harmful to the economy, will result.

It is our belief that the Congress may not have anticipated the results described in this report and that the Congress would have taken cognizance of them had time permitted a full presentation to the appropriate committees of the effect of this law.

BANK DEPOSITS HAVE GROWN MUCH FASTER THAN BANK CAPITAL

Bank capital, the equity that provides the element of protection for bank depositors, has not kept pace with the rapid increase in deposits during the past 10 years. State banking departments, the Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Federal Reserve System have all been aware of this development.

The implications of this situation are that the banking system can ill afford another inflationary deposit expansion such as took place during and after World War II without seriously jeopardizing the position of the depositor, the stockholder, and finally the entire banking system and the type of economy it represents.

The charts on the opposite page depict the rapid growth in deposits, relative to capital, for all member banks of the Federal Reserve System, deposits of which comprise about 75 percent of the total bank deposits of the United States.

DEPOSITS AND CAPITAL--ALL MEMBER BANKS

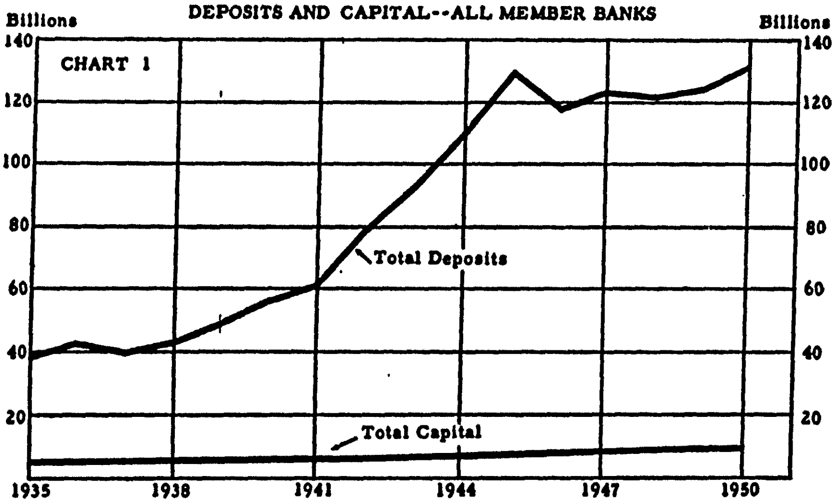


Chart 1, above, shows that from 1935 to 1950 the deposits of all member banks increased from about $38 billion to about $131 billion, an increase of over 240 percent.

In the same period the capital structure of all member banks increased from $5.1 billion to $9.7 billion, an increase of less than 90 percent.

(The temporary peak in deposits shown in 1945 resulted from an extraordinarily large Treasury fund balance created in anticipation of Treasury cash requirements which did not fully materialize.)

RATIO OF DEPOSITS TO CAPITAL--ALL MEMBER BANKS

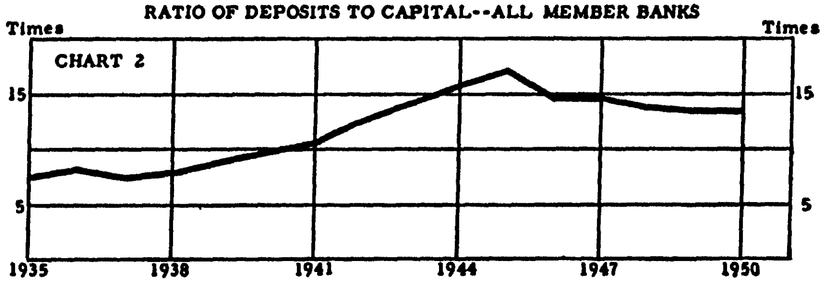


Chart 2, above, shows the trend of the ratio of deposit liabilities to capital for all member banks based on the figures in chart 1.

The rising ratio of deposits to capital reflects the decreasing size of the capital structure of the banking system in relation to the level of deposits supported thereby.

In 1935 each $1 of deposits was protected by more than 13 cents of bank capital; today only 7.5 cents of bank capital is available for the support of each $1 of deposit liability.

BANK CAPITAL SHORTAGES ARE NOT GEOGRAPHICALLY UNIFORM

Bank deposits are free to flow into areas of greatest economic activity as these areas expand their production and the volume of their transactions.

Bank capital, however, does not move freely from areas of redundant capital to areas where additional capital is needed.

Thus we find that certain of the older centers of economic activity, such as New York City, are holding a steadily declining proportion of the Nation's deposits and as a result they have an ample supply of bank capital, while the newer, more rapidly growing production centers are in need of additional capital. In other words, bank deposits have a higher degree of mobility than bank capital.

This phenomenon is illustrated by the charts on the opposite page.

PERCENT OF ALL MEMBER BANK DEPOSITS

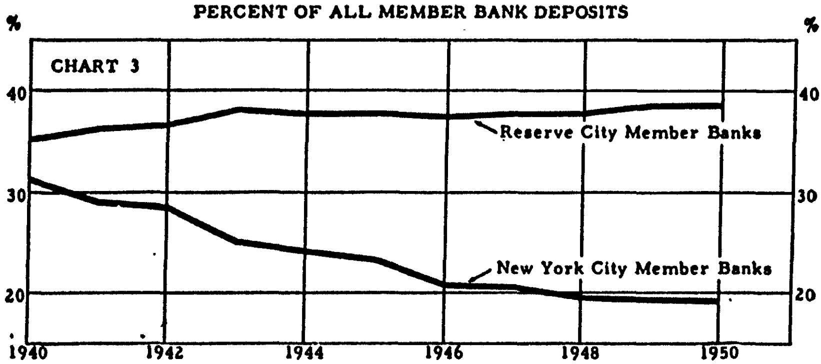


Chart 3 shows that member banks in New York City held nearly 32 percent of all member bank deposits in 1940 but now hold less than 20 percent of all such deposits.

Simultaneously, the percentage of all member bank deposits held by Reserve city member banks increased from about 35 percent in 1940 to nearly 39 percent in 1950.

So-called country member banks also increased their percentage of all member bank deposits substantially in this period.

RATIO OF DEPOSITS TO CAPITAL--NEW YORK AND RESERVE CITIES

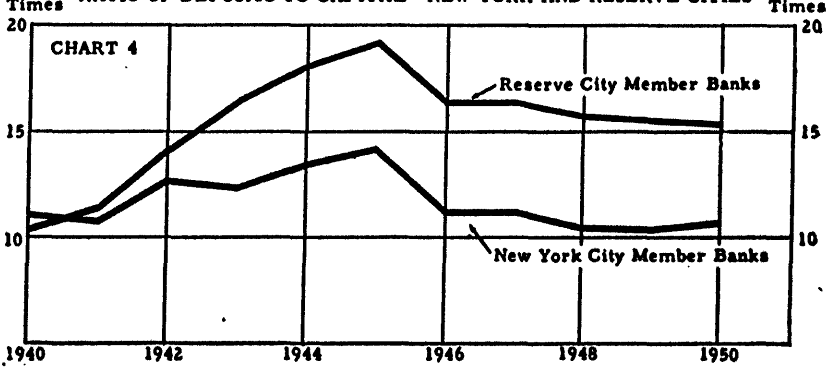


Chart 4 shows the ratio of deposits to capital—capital ratio—for Reserve city member banks and New York City member banks.

It can be seen that in 1940 the capital ratios for these two classes of banks were about the same. The subsequent shift in deposits has far out-run the shift in capital, with the result that the capital ratio for New York City member banks is now less than 11 to 1 compared with a ratio of over 15 to 1 for Reserve city member banks.

As will be shown on the following pages, the growth in deposits, when considered on the basis of individual cities, has created even more extreme capital ratios.

BANK CAPITAL SHORTAGES ARE EXTREME IN SOME AREAS

In many rapidly growing centers the increase in deposits has been considerably greater than the average for all Reserve cities.

The result of this more rapid growth in deposits is that capital ratios on the average are higher in such centers than elsewhere.

PERCENTAGE INCREASE IN DEPOSITS 1940-1950
MEMBER BANKS IN SELECTED CITIES

CHART 5

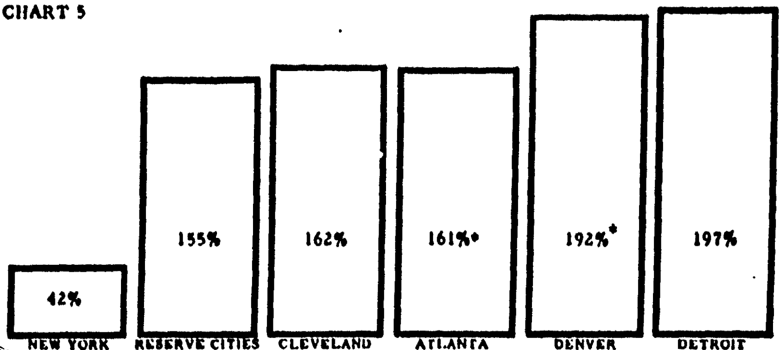
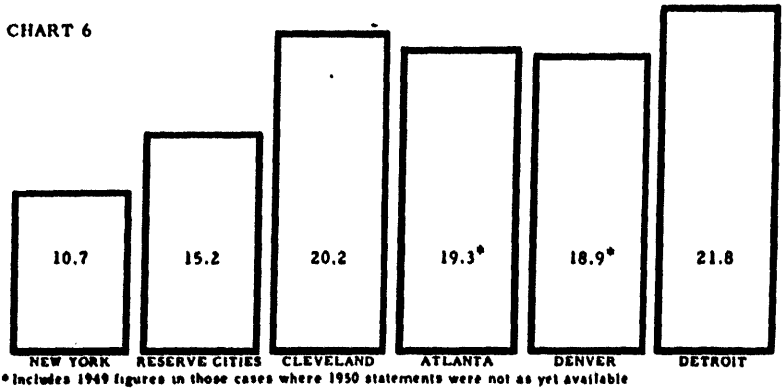


Chart 5 shows the change in deposits for member banks in selected localities in relation to the changes for member banks in New York City and all Reserve cities.

1950 RATIO OF DEPOSITS TO CAPITAL OF MEMBER BANKS IN SELECTED CITIES

CHART 6



* Includes 1949 figures in those cases where 1950 statements were not as yet available

Chart 6 shows the capital ratios of member banks in the same cities. It demonstrates that where deposits have increased most, capital ratios are least favorable. This is due to two factors:

First, capital ratios were generally unfavorable in these cities after the banking collapse of the early thirties and had not shown marked improvement by 1940;

second, bank capital in these places has not been obtained or created at a rate commensurate with the increase in bank deposits since 1940.

THE EXCESS PROFITS TAX WILL STRIKE HARDEST AT THOSE FEW BANKS MOST IN NEED OF CAPITAL

Table I on the opposite page shows that there are approximately 14,000 commercial banks in the United States consisting of 6,868 member banks of the Federal Reserve System and 7,264 banks which are not members.

The table also shows that 10,646 or 75.5 percent of the banks had deposits of under $5 million at the end of 1949; 3,305 or 23.2 percent had deposits of between $5 million and $100 million; and that only 181 or 1.3 percent had deposits of over $100 million. Only six banks with over $100 million in deposits were not members of the Federal Reserve System.

TABLE I.—*Distribution of banks by size groups on Dec. 31, 1949*

Type of banks	Total number	Number of banks with deposits—		
		Under $5,000,000	Between $5,000,000 and $100,000,000	Over $100,000,000
Federal Reserve members	6,868	4,267	2,426	175
Nonmember banks	7,264	6,379	879	6
Total all United States banks	14,132	10,646	3,305	181

It will be demonstrated below that approximately 98 percent of the 14,000 banks in the United States will not be subject to excess-profits tax to any significant degree. Generally speaking, this is accounted for by the $25,000 minimum excess-profits tax credit or by the higher rates of return (12 percent and 10 percent) allowed on the first $10 million of invested capital. The distribution of capital ratios is such that practically all of the banks with less than $100 million in deposits will get the benefit of these higher credits in computing their excess-profits tax.

This means that the remaining banks, numbering approximately 180, will be the only banks in the country which will be subject to excess-profits taxes to any important degree. The details supporting this statement are shown in table II, and are explained as follows:

The figures given in table II are for member banks only. Corresponding figures for nonmember banks are not available, but as mentioned above only six of these have deposits of over $100 million.

TABLE II.—*All member banks, 1949 earnings*

Deposit class	Number of banks	Total capital	Total pre-tax earnings	Average capital per bank	Average earnings per bank	Excess profits tax credit
$1,000,000 and under	507	$40,901,000	$4,204,000	$81,000	$8,000	$25,000
$1,000,000 to $2,000,000	1,368	187,349,000	22,408,000	137,000	16,000	25,000
$2,000,000 to $5,000,000	2,392	615,141,000	74,402,000	257,000	31,000	31,000
$5,000,000 to $10,000,000	1,241	640,452,000	70,437,000	516,000	62,000	62,000
$10,000,000 to $25,000,000	778	834,390,000	95,280,000	1,072,000	122,000	129,000
$25,000,000 to $50,000,000	267	594,619,000	64,795,000	2,227,000	243,000	267,000
$50,000,000 to $100,000,000	140	620,358,000	65,209,000	4,431,000	466,000	532,000
Over $100,000,000	175	5,621,150,000	554,110,000	32,121,000	3,166,000	2,870,000
Total	6,868	9,154,366,000	956,935,000			

It can be seen from table II that for all member banks with deposits under $100 million, the average earnings for each size group are no higher than the computed excess-profits-tax credit arrived at by applying the allowed rates of return to the average amount of capital. For banks with deposits of less than $2 million, the $25,000 minimum exemption will generally be greater than the earnings of a bank of this size.

It might appear from the law of normal distribution that where the excess-profits-tax credit is identical with the average earnings, one-half of the banks would pay some tax and the other half would pay no tax. There are, however, further considerations leading to the conclusion that few, if any, banks in such a size group would be subject to the tax. For example, the earnings shown in table II probably include income from tax-exempt and partially tax-exempt securities, capital gains, etc., which are exempt from excess-profits tax.[1]

With respect to the absence of corresponding figures on nonmember banks it should be pointed out that 87 percent of these banks are very small, having deposits of less than $5 million.

If the statistical integrity of this analysis is accepted, it seems clear that the excess-profits tax as now written impinges on a very small proportion of the Nation's banks * * * something of the order of 2 percent of the total number.

This circumstance does not lead to the conclusion that the law is just or equitable. It singles out a very few banks to bear the whole burden of the tax.

This conclusion has additional significance when it is considered that most of the largest banks in the country, namely, most of those in New York City, will be exempt from the tax by virtue of their abundant capital. Statements to this effect were made by the managements of many such banks at stockholders' meetings in January 1951.

The ultimate effect of the Excess Profits Tax Act of 1950, therefore, is to tax almost exclusively banks of intermediate size outside of New York City. These banks are those discussed in previous pages and characterized as being in rapidly growing centers where bank capital is needed.

In other words, the tax falls most heavily on those banks most in need of capital.

THE AVERAGE EARNINGS METHOD OFFERS NO SOLUTION TO BANKS AS IT DOES TO OTHER TYPES OF CORPORATIONS

Unlike other industries in which some companies will elect the average earnings base while others will compute their excess-profits-tax credit by the invested-capital method, it seems safe to assume that practically all banks will be forced to use the latter method.

This is not because banks are enjoying substantially higher earnings than in the base years, but is for the reason that under the law, banks are not permitted to include in their base year earnings, income from partially tax exempt Government bonds. This situation is described below:

In the normal course of business, banks have a substantial portion of their resources invested in United States Government securities.

Government securities issued prior to March 1, 1941, were partially tax exempt (exempt from Federal normal-income tax but subject to surtax), while those issued subsequently have been fully taxable. The amount of partially tax exempt bonds outstanding has been steadily declining because of maturities and redemptions.

Most banks had an important amount of income from partially tax exempt bonds during the base years, 1946–49, as defined under the present excess-profits-tax law. This income, exempt from excess-profits tax, may not be included in computing the excess-profits-tax credit under the average earnings method.

As the partially tax exempt bonds mature, the banks, perforce, replace them with fully taxable bonds thus subjecting a considerable amount and an increasing proportion of their income to normal tax and "excess" profits tax. In this process, however, there is no real gain in net earnings before excess-profits tax. There is merely a change in the tax status of an important part of the income received by banks.

The excess-profits-tax credit available to banks under the average earnings method is artificial, therefore, in relation to the total income of most banks and is not a practical, true, or equitable base for determining "excess" profits. Banks, in effect, have no alternative to the use of the invested capital method for computing their excess-profits-tax base. They differ from all other industries in this respect.

[1] This income would be offset in part by reduced EPT credits due to holdings of inadmissible assets. Table II does not exclude the exempt income or allow for the adjustments in the credits.

PARTIALLY TAX EXEMPT FEDERAL SECURITIES OUTSTANDING

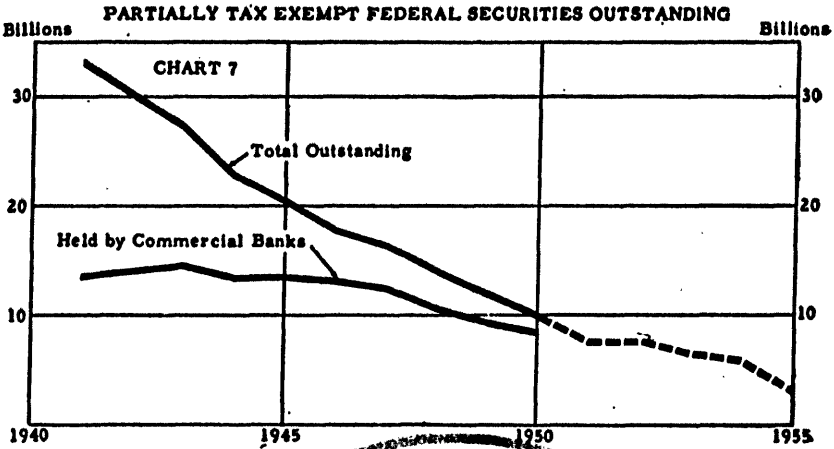


Chart 7 shows how the supply of partially tax exempt Federal securities has declined from more than $33 billion in 1941 to about $11 billion at the end of 1950.

The chart also shows how commercial bank holdings of this class of investment have been forced downward in recent years.

The projection of the total available supply indicates that within 5 years virtually all partially tax exempt Federal securities will be eliminated from bank portfolios.

% IMPORTANCE OF PARTIALLY TAX EXEMPT SECURITIES IN BANK PORTFOLIOS %

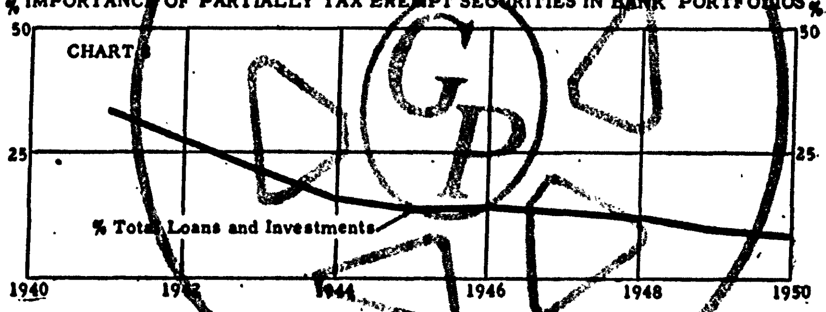


Chart 8 shows how the partially tax exempt bonds have declined in importance as a part of all bank loans and investments (earning assets).

In 1941 nearly 30 percent of all commercial bank earning assets consisted of partially tax exempt Federal securities (prior to 1941 all U. S. Treasury bonds were partially tax exempt). Today, the percentage stands at less than 7 percent.

By the end of 1951 it is likely that the amount of partially tax exempt Federal securities held by commercial banks will be less than one-half the amount held by these banks during the 1946–49 period and by the end of 1955 the amount is expected to be less than one-third the 1946–49 period.

BANKS CANNOT SOLVE THEIR PROBLEM BY RAISING MORE CAPITAL BECAUSE EARNINGS ARE ALREADY TOO SMALL TO ATTRACT NEW CAPITAL ON A REASONABLE BASIS

From the standpoint of the comparatively small number of banks in growing cities where capital is short in relation to deposits and which, accordingly, will generally be subject to heavy excess-profits taxes, it would seem that the solution would be for those banks to acquire additional capital. This would improve the position of such banks and at the same time afford important relief from excess-profits taxes.

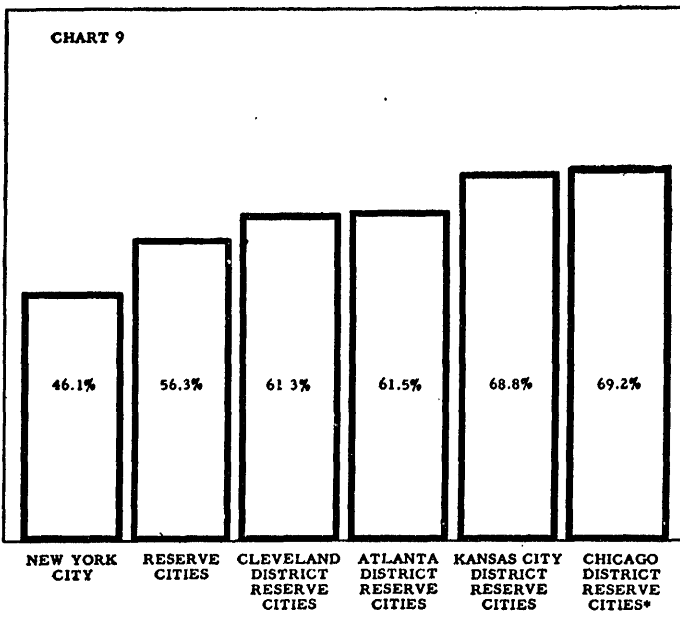
There are only two sources for the acquisition of additional capital for a bank. One of these is the reinvestment of earnings after the payment of dividends; the other is the sale of additional stock.

With respect to the first alternative, chart 9 shows that those areas most in need of additional bank capital have retained very substantial proportions of earnings. Dividends have been held to a minimum in order to provide additions to capital structures. To further restrict or curtail dividend payments is to make more remote the posssibility of acquiring additional capital through the sale of stock at any time in the future.

Chart 9 also shows that in the period 1941–49 New York City member banks retained only about 46 percent of their earnings. Member banks in all Reserve cities retained 56 percent of their earnings. Excluding the city of Chicago itself, banks in the Chicago Federal Reserve district retained nearly 70 percent.

It is clear, then, that banks needing additional capital have operated under extremely conservative dividend policies while those with ample capital paid out a more normal percentage of their earnings in dividends.

AVERAGE PERCENT OF EARNINGS RETAINED 1941-1949
MEMBER BANKS IN SELECTED AREAS



*Includes Detroit but not Chicago

With respect to the other alternative, namely, that of raising capital through the sale of additional stock, this avenue is not readily accessible because of the fact that bank stocks in general sell at substantial discounts from book value. This is true even in New York City, where a relatively large proportion of earnings are paid out in dividends. If rights to sbuscribe for additional stock are offered at a price that is below book value, those stockholders (frequently smaller holders) who are not eager and may not be in a position to make an additional investment will have their equity diluted in a manner which many would consider unfair.

Stated otherwise, it is frequently impossible to find a way to price new bank stocks that is at once attractive to shareholders and advantageous to the banks needing the capital.

If this problem is to be squarely faced, it must be admitted that certain banks are badly in need of additional capital and that if the necessary capital is to be obtained the banking system must be allowed sufficient earnings either to generate the required capital internally by means of retained earnings or to attract new capital by presenting an attractive competitive alternative for the investment of new funds in the capital markets.

The record of the past 15 years indicates that with extraordinary Federal control of interest rates and other operating conditions, banks have not been able to earn at a rate comparable to other types of business. Because of low earnings, banks generally have not been able to enter the money markets for new capital on a fair and reasonable basis and have not been able to retain sufficient earnings as an alternative.

RATIO OF MARKET TO BOOK VALUE

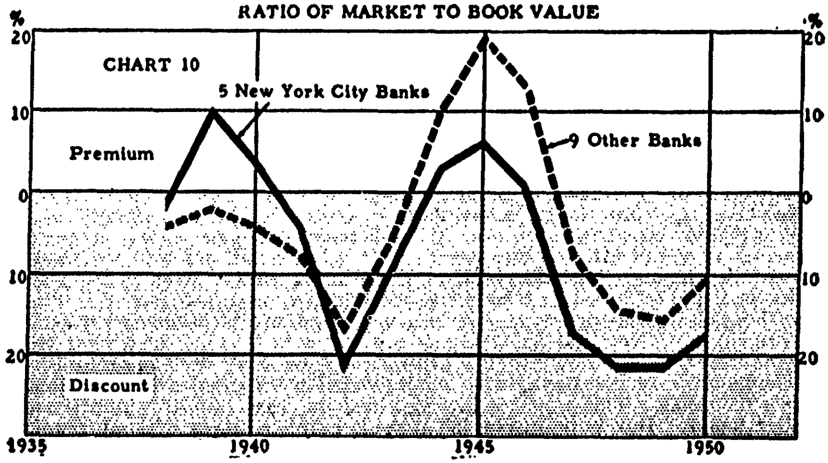


Chart 10 shows that, for the banks indicated, the average price of bank stocks has been substantially below the book values per share of such stocks in most years since 1940.

RETURN ON INVESTED CAPITAL
(3 year moving average)

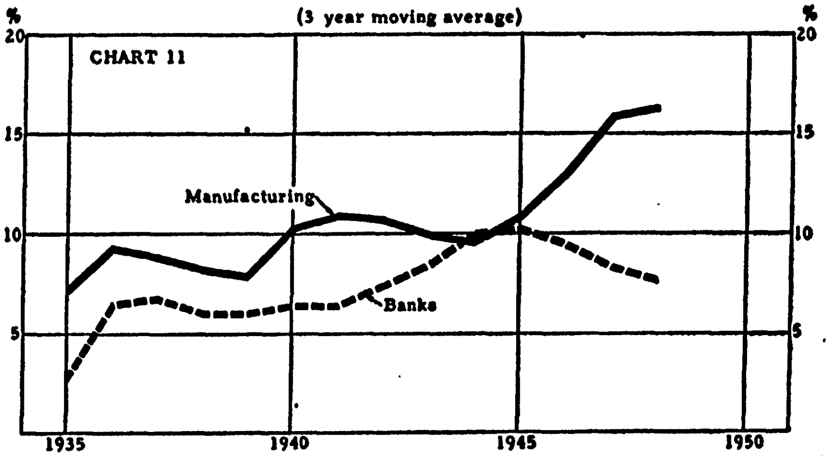


Chart 11 shows the return on invested capital for a group of 45 manufacturing industries and for all member banks for the period 1935 to 1949.

Over the 15-year period, the average rate of return earned by banks was approximately 65 percent of the average rate of return earned by the other industries.

From this it is clearly evident that the banking industry has not been a high-profit industry.

ADDITIONAL CONSIDERATIONS

Under the invested-capital method the 8-percent rate of return (before income taxes) allowed on capital in excess of $10 million does not permit many growing banks to earn amounts sufficient to create or attract new capital. The net return, after income taxes, becomes approximately 4 percent and with excess earnings taxed at 77 percent, great difficulty would be experienced by banks subject to excess-profits tax in earning as much as 5 percent net.

Banking is an essential industry. The problem presented here is not basically one of affording relief for bank stockholders but of permitting the industry, or certain affected segments of it, to have sufficient earnings so that the essential functions of banking for the over-all economy may be performed adequately and without strain. As stated recently by the New York State Superintendent of Banks:

"Banking is so closely entwined with the public interest that any undermining of its strength is of direct concern not merely to the owners of the banks but to the public generally."

In discussing the most recent of a long series of bank mergers, the American Banker editorially describes the acquisition by a large New York bank of a smaller independent bank as follows:

"The sale of the National Safety Bank by its principals reflects, of course, the current depressed condition of public investment interest in banks. Were banks in New York as attractive to investors as other investment opportunities, there would probably be a syndicate of individuals ready and eager to put up the millions that it would take to buy control of the bank and get into the banking business in this area. But costs are up and interest rates, even in the needle-trades area, are ceilinged to a level where banking runs a poor second to almost everything else investmentwise. Hence, in their desire to liquefy their estates, the principals of National Safety Bank are resorting to an arrangement which consists largely of the now familiar practice of liquidating their bank by sale of the assets to a bigger bank, with capital adequate to underwrite the smaller bank's liabilities. This practice has provided an escape for the proprietors of smaller banks. But only insofar as it adds earning assets without requiring proportionate increase in capital for the larger bank, does it offer even small relief for the unhealthy investment situation of the stocks of the larger banks."

The excess-profits-tax law gives special treatment to the airlines, the public utilities, and the railroads. It is understood that one of the underlying reasons for the special treatment afforded these industries is that their profits are already regulated by State or Federal authorities.

In a sense commercial banking is also a regulated industry. The price of its principal commodity, bank credit, has long been regulated by the Federal Reserve Board and the Treasury. The character and quality of commercial bank assets is subject to the scrutiny of such Federal authorities as the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation, and by banking departments in every State.

The amount of reserves which must be maintained in the form of a nonearning asset is prescribed by the Federal Reserve Board in the case of member banks and by State authorities in the case of nonmember banks. Such authorities may and do instruct banks as to what assets must be charged off and as to the quality of investments which may be held. Regulations also prescribe the amount of money that may be loaned to any one borrower and the amount that may be invested in any one issue of securities.

It is thus clear that from many viewpoints the commercial banking industry may logically be regarded as a regulated industry. As such, there is a basis for providing banks with special treatment under the excess-profits-tax law.

Suggestions as to how the law might be amended to correct the conditions outlined in this report are available in a separate memorandum.

SOURCES OF STATISTICAL DATA

Chart 1: (*a*) Banking and Monetary Statistics,[3] page 75; (*b*) Federal Reserve Bulletin, January 1951, page 55; (*c*) Federal Reserve System News Release G. 7 January 30, 1951.

[3] Published by the Board of Governors of the Federal Reserve System, 1943 edition.

Chart 2: (a) Same as for chart 1.

Chart 3: (a) Banking and Monetary Statistics,[3] pages 75, 82, 94; (b) Federal Reserve Bulletin, January 1951, pages 55, 56; (c) Federal Reserve System News Release G. 7, January 30, 1951.

Chart 4: (a) Same as for chart 3.

Chart 5: (a) New York City and all Reserve cities same as in chart 3; (b) All other data compiled from Moody's Bank Manual of 1941 and the current supplements to Moody's Bank Manual for 1951.

Chart 6: (a) Same as for chart 5.

Chart 7: (a) Treasury Bulletin, June 1941, page 1; February 1944, page 40; March 1945, page 48; March 1946, page 51; March 1947, page 49; March 1948, page 30; March 1949, page 31; March 1950, page 33; February 1951, page 30.

Chart 8: (a) Federal Reserve Bulletin, January 1951, page 55; (b) For other data see data for chart 7.

Chart 9: (a) Banking and Monetary Statistics,[3] pages 267, 270; (b) Federal Reserve Bulletin, July 1943, pages 672, 674; May 1944, pages 500, 502; May 1945, pages 491, 493; June 1946, pages 674, 676; May 1947, pages 602, 604; May 1948, pages 576, 578; May 1949, pages 583, 585; May 1950, pages 588, 590.

Chart 10: (a) The statistical series for this chart were compiled by taking the adjusted book value and market prices from Standard & Poor's Corporate Records for each of 14 bank stocks and combining them into a group average with each bank weighing equally. New York City: Bankers Trust, Central Hanover, Chase National, Chemical Bank, National City; Nine other banks: Cleveland Trust, Commerce Trust (Kansas City), Continental-Illinois, Detroit Bank, First National (Chicago), First National (St. Louis), Manufacturers National (Detroit), National Bank of Detroit, Security First National (Los Angeles).

Chart 11: (a) National City Bank of New York series as reprinted in the Economic Almanac for 1950 on page 413; (b) National City Bank of New York monthly bulletins of April 1942, 1944, 1946, 1948, and 1950; (c) Banking and Monetary Statistics,[3] page 265; (d) Federal Reserve Bulletin, June 1946, page 681; (e) Federal Reserve Bulletin, May 1950, page 595.

Table I: (a) Federal Reserve Bulletin, May 1950, page 592; (b) Nonmember bank data obtained directly from Federal Reserve Board.

Table II: (a) Federal Reserve Bulletin, May 1950, page 592.

Senator BYRD. In lieu of an appearance the Chair inserts in the record a statement of Mr. Joseph L. Hull, general counsel of the Seismograph Service Corp., of Tulsa, Okla.

(The document referred to follows:)

SEISMOGRAPH SERVICE CORP.,
Tulsa, Okla., July 25, 1951.

SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

GENTLEMEN: We respectfully submit the enclosed statement with regard to section 123, revenue bill of 1951, H. R. 4473, for the consideration of the committee in connection with its study of current revenue legislation.

Yours very truly,

JOSEPH L. HULL, Jr.,
General Counsel.

STATEMENT OF JOSEPH L. HULL, JR., GENERAL COUNSEL, SEISMOGRAPH SERVICE CORP., TULSA, OKLA.

H. R. 4473, revenue bill of 1951, approved by the House of Representatives and now under consideration by the Senate, contains, in section 123 thereof, provisions drastically changing the existing tax policies relating to business enterprises carried on in certain corporate forms. The intended purpose of this statement is to bring to the attention of the committee certain inequities, discriminations, discrepancies, and hardships which, it is believed, may result from the application of section 123, H. R. 4473, if enacted.

Section 123, H. R. 4473, of the revenue bill of 1951 in general provides for the limitation of a group of affiliated corporations to one $25,000 surtax exemption and one $25,000 minimum excess-profits credit. The section amends section 26, Internal Revenue Code, which provides for certain credits of corporations by add-

[3] Published by the Board of Governors of the Federal Reserve System, 1943 edition.

ing the provision for limitation on surtax exemption. Although no specific $25,000 credit appears in section 26, Internal Revenue Code, section 15, providing for the imposition of the surtax on corporations, grants a $25,000 exemption. Section 121 of the bill now proposes to amend section 15 to grant an exemption only to the extent of that specified in the provisions of section 123. Therefore, although this statement is confined to the questions raised by section 123, the points of discussion are equally applicable to section 121 as it appears in the revenue bill.

The $25,000 general exemption to corporations under the surtax provisions first appeared in our revenue laws in the Revenue Act of 1950. Prior to that time and since the Revenue Act of 1941, a surtax had been imposed on a graduated scale upon incomes up to $25,000. The purpose of the flat exemption, as contained in the Revenue Act of 1950, is indicated by these words in the Senate report:

"A single exemption of the type in the bill best expresses the idea of a flat tax rate modified by a concession for small business. It is much simpler than a system of multiple exemptions and can be presented on the return form in a way which makes it easier for the taxpayer to compute the return."

The reason for the limiting provisions of section 123, as contained in the report of the Committee on Ways and Means, is stated as follows:

"Under existing law the $25,000 corporate surtax exemption and the $25,000 minimum credit under the excess-profits tax are available to each member of a group or chain of related corporations even though the degree of their association is sufficiently great so that they are virtually a single business enterprise. This treatment confers an unwarranted tax advantage on businesses carried out by means of a series of corporations, rather than a single corporation, and sets up an incentive for the artificial splitting up of corporations. This effect of the existing law is difficult to reconcile with the fact that the surtax exemption and the minimum credit were intended to confer tax advantages on small business. Therefore, section 123 of this bill reduces to one the number of surtax exemptions which may be claimed by a group of related corporations and limits the minimum excess-profits-tax credit to a single credit of $25,000 for the entire group."

It appears, therefore, that this House committee continues to sanction the $25,000 surtax exemption to corporations, but seeks simply to prevent the abuse of the exemption provision where the enjoyment thereof would be in contravention of the purposes for which the exemption is given. The House committee, however, assumes the position that a corporation which might otherwise be classified as a small business cannot be so classified when a member of an affiliated group of corporations; or, if a parent corporation; or, if a single subsidiary of a corporation; or, if controlled by an individual who controls one or more other corporations. We respectfully submit, in the following portions of this statement, points of consideration which we believe evidence a fallacy in the House committee's position, and which indicate the hardships and inequities which will result from the provisions of section 123 based upon such discriminatory views.

The provisions of section 123 require that any corporation which is a member of a controlled group on December 31 of any year shall be deemed a related corporation and subject to the limitation of its surtax exemption and minimum excess-profits credit. This would mean that all related corporations, regardless of when formed or acquired and for what purposes, existing on December 31, 1951, shall be subject to this limitation. Although these provisions are to be enacted for the expressed purpose of preventing abuses of the surtax exemption and excess-profits credit, no opportunity is provided for justification by the taxpayer of such actions taken in the prior formation or acquisition of related corporations. It is simply presumed that all such corporations are the result of artificial splitting up to avoid taxation. Thus, a so-called related corporation, organized or acquired for valid reasons and engaged in business of small proportions, shall be penalized by limitation of its exemption and credit for the sole reason that its outstanding stock is owned by another corporation, rather than individual stockholders. Similarly, this provision means that a corporation which may have operated for years relying to a certain extent upon the enjoyment of the surtax exemption, may suffer the imposition of added surtaxes for the taxable year by the purchase of its outstanding stock at any time during the year by an individual owning some other completely unrelated corporate enterprise, or by the purchase of its outstanding stock by a corporation engaged in some other unrelated business. Unless it can be said that the mere ownership of the outstanding interest in a corporation by another corporation, or by the owner of another corporation, enhances the competitive position of such corporations, surely it is evident that the penalty placed upon such corporation by the provisions in question might substantially affect its ability to compete with similar corporations not encompassed by such provisions.

Certain cases exist, and will arise in the future, where a separate corporate structure for the operation of an unrelated business is required, regardless of the tax consequences thereof. The formation of separate corporate entities in such cases is based upon valid business reasons or requirements, such as the need for separation of business ventures for accounting and financial purposes; the necessity to retain a certain corporation name for good will and competitive purposes; the requirements of certain State corporation laws that a corporation to be admitted may carry on but one business; and, most important, the limitation of liability which may be created for a new business venture. The latter purpose in forming a separate entity controlled by another corporation or by an individual controlling another corporation is probably the most important and prevalent of all. Many organizations, by reason of research and development, or energetic initiative, find themselves in a position to enter fields wholly unrelated to that in which they are primarily engaged. But the entry into such fields constitutes a new and sometimes hazardous business risk with many unknown liabilities which may arise. In the beginning stages of such ventures, any one liability—such as a patent infringement, a tort liability, or an innocent violation of the myriad of Government regulations providing multiple damages—could seriously affect the financial structure of the basic organization. The new venture, therefore, is carried on through a separate corporate entity in accordance with the sound judgment and customary business practices which have existed in this country throughout the years of its industrial growth. The section 123 in question now seeks to penalize the exercise of such judgment and the application of sound business practices, while professed to be intended to prevent abuse of the exemption and credit provisions. In most cases of existing related corporations, the limitation of exemption and credit would be received as an additional discriminatory increase in the already heavy corporate tax burden. In the cases where establishment of a new business is under consideration, certainly these limitations would be a substantial deterrent to such plans.

Faced with the peculiar situation of meeting the threat of inflation through expanded civilian production while shouldering the burden of rebuilding the military defenses of the free world, this country and its industrial component has accepted the challenge in the face of heavier tax burdens and increasing limitations on its freedom of action. The willingness of industry to meet the challenge must be nurtured and stimulated with the minimum of subsidy and privilege from the Government. It demands only that the burdens it must carry into this period be distributed and borne on an equitable basis, and, most important, that the right to compete in the market places be preserved and protected to the greatest extent commensurate with the public health, safety, and welfare. Legislative discrimination between competing business organizations based entirely upon the character of ownership is discrimination in its most despicable form. Except for classification of the nature of corporate organizations for specific and valid purposes, the tax laws of this country have never contained provisions which distinguish between corporate organizations for tax purposes solely on the basis of the character of ownership. The effect of such discrimination upon the initiative to create new business enterprises in the form of related corporations, so constituted for valid reasons, is one easily computed and simple to understand. For the sake of illustration, consider the following comparable situations:

The XY Corp. through research, develops a product which it believes can compete successfully in a wholly unrelated business. It has $100,000 to invest in the establishment of such business, which, for valid reasons, it feels requires a separate corporate organization. Assuming its earnings in this new business for the taxable year are $25,000, this new corporation will pay taxes (based on 1951 rates) as follows:

Normal tax at 25 percent	$6,250
Surtax at 22 percent	5,500
Excess-profits tax at 30 percent (assuming invested capital credit of $12,000)	3,900
Total	15,650

Meanwhile, John Doe, an individual owning no other corporate businesses, owns all of the stock of a corporation engaged in the business with which the above corporation intends to compete. Assuming John Doe's investment was

$100,000, and his corporate earnings $25,000 in the taxable year, his corporation will pay taxes (based on 1951 rates) as follows:

Normal tax at 25 percent	$6,250
Surtax	None
Excess-profits tax	None
Total	6,250

Obviously, the XY corporation will retain out of the earnings of its new corporation less than half of the amount which John Doe's corporation will retain. In addition, the XY corporation will be required to pay a tax of approximately 7 percent of the amount left if it should desire to receive the remaining earnings as a dividend. Also obviously, John Doe's corporation, earning twice as much after taxes as XY's subsidiary corporation out of the same amount of earnings before taxes, can undersell XY's subsidiary at any time it should desire. Certainly XY corporation, in its considerations to enter this new business under such circumstances, would have little desire to face competition of such type, where no amount of initiative and effort on the part of its personnel could overcome the competitive disadvantage imposed upon it by section 123.

More important in these times are the same facts when related to defense production. Many corporations, being urged to consider defense production and realizing the uncertainties incumbent in war contracts, including the retroactive operation of renegotiation, the unpredictability of longevity, the more restrictive labor provisions, and the frequent requirements of internal security, believe that a separate corporate organization is not only feasible but required in the ordinary exercise of sound business judgment. Having so concluded, they will be faced immediately with the problem illustrated by the examples above, wherein it is obvious that in open bidding they would be unable to compete. If contracts were obtained without competitive bidding, the cost of the product to the Government, reflecting the higher taxes, would be proportionately higher than that for which it could be furnished otherwise. Thus it appears that section 123 would be a deterrent to expansion and competition in defense production, which would result inevitably in higher costs to Government.

To this point, the matters urged in this statement have been discussed in behalf of those corporations and individuals who have acquired or will acquire related corporations for valid business purposes. It should not be inferred that the artificial split up is sanctioned in any degree. Tax legislation which would allow unrestrained, artificial splitting up of corporations solely for tax purposes would be as objectionable to such corporations and individuals as the section here under consideration. Such legislation would obviously afford a tax advantage to those willing to operate a single business through a number of related corporations and would therefore place the greater tax burden upon the corporations conducting similar businesses along customary lines of sound business practices. Again, the final effect would be upon the respective competitive efforts of the businesses so differently organized. It was not the intention of Congress in establishing the $25,000 exemption against surtax income that such split-ups should be encouraged. To the contrary, it was stated in the Senate report on the Revenue Act of 1950 that:

"Under this plan, the so-called 'notch-provisions' are eliminated. It is not intended, however, that the exemption of the first $25,000 of a corporation's surtax net income from the surtax shall be abused by the splitting up, directly or indirectly, of a business enterprise into two or more corporations or the forming of two or more corporations to carry on an integrated business enterprise. *It is believed that Sections 45 and 129 will prevent this form of tax avoidance.*" (Italics supplied.)

The sections 45 and 129 referred to gave unprecedented power to the taxing authorities to make adjustments in income, credit, deduction, and exemption calculations on the returns of all taxpayers where tax avoidance was evident. The mere existence of such provisions in the Revenue Code has been a powerful deterrent to the institution of many tax avoidance schemes which probably would have escaped discovery by revenue officials. It is submitted that there is no dearth of safeguards against the problem which Section 123 purports to resolve, but only perhaps a deficiency in the full and proper utilization of the methods of prevention now existing. If stronger preventive legislation is required, the sections referred to may be strengthened, leaving individual cases of tax avoidance to be dealt with on the basis of facts disclosed. The cure or the preventive should be the individual treatment provided in such Sections, not the mass amputations required by Section 123.

Special consideration should be given to the effect which section 123 will have upon the far-seeing policy instituted in support of this country's foreign trade as contained in the provisions for the Western Hemisphere Trade Corporations. In 1942, corporations engaged in business deriving 95 percent of their income from sales outside the United States and 90 percent from within the Western Hemisphere were afforded exemption from all surtaxes and excess profits taxes. After repeal of the excess profits tax provisions, the exemption from all surtaxes remained as a stimulant to foreign trade until the Revenue Act of 1950, at which time the special exemption was eliminated and a 33 percent credit against normal and surtax net income was substituted. In the Excess Profits Tax Act of 1950, these corporations were again exempted from such tax. Section 123, here under consideration, makes no provision for these corporations, thus bringing them within the limitations on surtax exemptions where they may be "related" corporations. Recalling the reasons given for the inclusion of section 123 in the tax bill, being the prevention of corporate split ups for tax avoidance, we call attention to a serious inconsistency. At the time preferential treatment was first offered Western Hemisphere corporations, there was widespread hesitancy with regard to the formation of subsidiary corporations to take advantage of the benefits allowed, chiefly in view of the provisions of section 45. Later, with the enactment of section 129, providing that tax savings effected by the acquisition of control of another corporation for the purpose of evasion or avoidance of Federal taxes should be denied, the feeling was strengthened that such action was thus effectively prohibited. Then, in 1945, the Bureau of Internal Revenue ruled that section 129 did not apply to Western Hemisphere Trade Corporations, stating that:

"In view of the foregoing, it is held that the creation of a new domestic corporation to carry on the business in the Western Hemisphere (other than in the United States) of an existing domestic corporation does not constitute tax avoidance within the meaning of section 129 of the code, even though the new corporation was created for the principal purpose of gaining the benefits provided by the first exception in section 15 (b) of the code and by section 727 (g) of the code" (I. T. 3757, 1945 Internal Revenue Bulletin No. 17).

Thus appears the inconsistency of the proposal of section 123, presupposing the formation of subsidiary corporations, including these Western Hemisphere corporations, to be tax avoidance schemes, while the authorities charged with enforcement of preventive laws expressly rule that in the case of such special corporations their formation for such purposes is sanctioned by law. No evidence has been offered to support the conclusion that the following statements, contained in the Bureau's ruling, are no longer true:

"The exemption provided by the first exception in section 15 (b) of the code was intended primarily to remove competitive disadvantages created by double taxation with respect to the income of domestic corporations doing business to a substantial degree in foreign countries. (S. Rept. No. 1631, 79th Cong., 2d sess. (C. B. 1942-2, 504, 532).) The purpose of the enactment of section 727 (g) of the code appears to have been similar in nature. It is not believed that Congress, in enacting section 129 of the code, had any intention of repealing or otherwise varying existing benefits provided by the first exception in section 15 (b) and by section 727 (g) of the code. It appears from the structure of sections 109 and 727 (g) of the code. and the apparent purpose thereof, that Congress sought to make this relief available to any domestic corporation, provided only that it could satisfy the gross income and other specific requirements of those sections of the code. The absence of any other restrictions or conditions relating to eligibility for such relief leads to the conclusion that the basic policy underlying those sections contemplates that they shall apply to any domestic corporation which can, for a particular taxable year, satisfy such conditions as are specifically set forth therein without regard to the time of, or the occasion for, the organization of such corporation."

It therefore seems that the failure to provide for the Western Hemisphere corporations in section 123 is either an oversight or is an unwarranted reversal of congressional policy toward organizations furthering our foreign trade.

In view of the discussion contained in the foregoing, it is respectfully submitted that the following suggestions should be considered:

1. Section 123, H. R. 4473, should be eliminated from the Revenue Act of 1951.
2. If not entirely eliminated, section 123 should be amended to apply only to related corporations becoming members of controlled groups after December 31, 1950.
3. If not entirely eliminated, section 123 should be further amended to exempt Western Hemisphere Trade Corporations from the provisions thereof.

Senator BYRD. In lieu of an appearance, the Chair inserts into the record a statement from Tubular Micrometer Co. of St. James, Minn.

(The document referred to follows:)

TUBULAR MICROMETER CO.,
St. James, Minn., July 24, 1951.

COMMITTEE ON FINANCE, UNITED STATES SENATE,
Senate Office Building, Washington, D. C.

GENTLEMEN: We herewith request consideration of a tax problem which threatens the very existence of this corporation unless some form of adjustment in the excess profits tax law can be made. Our increased volume requires additional capital and is a strain on our cash position yet the present tax structure does not leave us enough profit to carry this additional volume and continue to retire our indebtedness on the basis to which we have been committed.

We are the only metalworking industry in this county. Our products consist primarily of small hand tools for use by the machinist and tool and die makers. Among others, these consist of micrometers, vernier calipers, height gages, machinist squares, combination squares, and so forth, being primarily confined to the category of hand measuring tools.

Under the present scale of defense production, we have more business than we can use. Our products are accepted by the various branches of the Government services, being purchased primarily by the Navy Purchasing Office in Washington, who purchases this type of tool for all the armed services. At the present time, we are holding prime contracts of somewhat over $1½ million and subcontracts totaling a substantial amount.

Our operations during World War II were considerably smaller than during this emergency. Nevertheless, we operated at a satisfactory profit until technicalities in contract terminations in 1945 reflected a net loss of $44,000 in that year. The present base-period of 1946–49 shows the following figures for our operations.

Fiscal year ended	Net sales	Net profit before taxes	Net profit after taxes
Jan. 31, 1947 [1]	$149,971.03	$3,102.12	$1,483.87
Jan. 31, 1948	540,322.06	2,075.07	1,600.78
Jan. 31, 1949	489,347.27	1,814.75	1,208.39
Jan. 31, 1950	533,027.84	2,734.39	1,917.03

[1] This was a 3-month period for an adjustment in the fiscal year.

During 1950 our net sales had increased to the point where the operations rose above the break-even point and ended the year with a profit of approximately $63,000 on $827,000 in net sales. This profit, of course, was before income and excess profits taxes.

During the period from 1946 through 1949, our average employment was about 135 people. We now employ 325 people. Sales in 1951 should total between $1½ million and $2 million.

The principal reason for our sales being so low during the base period was due to the fact that the many thousands of our tools and those of our competitors were thrown onto the market at greatly reduced prices by those in the salvage business. The salvage operators operated at a considerable profit to our disadvantage, due to the fact that they had purchased these tools from the War Assets for 5 to 10 cents on the dollar, and resold them at 50 cents on the dollar. During this period we had hopes that eventually the surplus tools would be off the market and we would again be able to operate at a satisfactory profit when the present defense program and the resultant excess profits tax law came into effect.

Our present volume of business demands that we expand our facilities. Our operations in the base period so depleted our cash that a 5 year amortization on a certificate of necessity does not appear to be the answer, due to the fact that cash requirements would necessitate borrowing and would reflect an unbalanced financial condition. We would not hesitate to borrow, however, in order to meet this emergency and do our part, if there was some hope that taxes would not eliminate us and that there would not be a reoccurrence of the "dumping" process after the emergency is over. It seems that when there is an emergency, our products are in great demand. When there is no emergency, we are competing with Uncle Sam for a market which should belong to this industry. The nature of this business is such that it takes years for a proper tooling program and therefore, precludes the possibility of converting to other products unless we discontinue this type of business entirely.

The writers of the present law evidently intended that distressed industry groups were covered by the various provisions such as arriving at a base through a percentage of the dollar value of the assets of the company during the base period. Other methods and alternatives are available, none of which allow a base which should average out at a satisfactory investment in this type of business through the base period and the present period of inflation. It appears that only those companies which are already strong receive protection in the present theory. There are less than one-half dozen in this type of business whose products are acceptable to the Navy Purchasing Office. Our three major competitors are all over 75 years old and have substantial means that allow them satisfactory profits. We manufacture very high quality products which are in acute demand. Our operations are efficient and our costs very favorable in the light of competition.

Is there no relief? If there is none, what course should we pursue? If we limit our profits by spending heavily for advertising to establish a market after the present emergency has passed, we will not have bettered our financial standing to the point where new customers will have confidence in our products. Is it not possible for a business such as ours to pay a just tax, contribute to the defense effort, and still remain sound financially?

Will it be possible in considering the new tax legislation that those who draft the new tax bill may give some consideration to the businesses which are not in the grocery-store class but are in the medium to upper brackets of the small-business classes. Is it possible that an allowance could be made to exempt a greater portion from the excess-profits base so that indebtedness could be paid during the time when the products of a business of this type are in great demand so that the business will be able to withstand the shock of reconversion when the demand subsides?

Your consideration of our dilemma will undoubtedly be welcome by other businesses which have the same problem.

Sincerely yours,

HOWARD M. JAMES,
President, Tubular Micrometer Co.

Senator BYRD. In lieu of an appearance, the chair inserts in the record a statement from Arthur J. Packard, dated July 26, 1951.

(The statement referred to follows:)

STATEMENT OF ARTHUR J. PACKARD

Mr. Chairman and gentlemen of the committee, I am Arthur J. Packard, president of the Packard Hotels Co., with headquarters at the Curtis Hotel, Mount Vernon, Ohio. I own and operate a chain of small hotels in the State of Ohio. I appreciate the opportunity of entering this brief statement with you in connection with hearings on increases in the Federal revenue. I am addressing you as a member of the governmental affairs committee of the American Hotel Association.

We appreciate the difficult problem your committee faces in attempting to raise up to $10 billion in additional revenue to finance a defense program which will adequately equip us to meet any expected emergency. We do feel strongly, however, that all Government expenditures should be carefully screened with a view to the elimination of nonessential disbursements in this critical period.

Although sometimes regarded as the seventh largest industry in America, the hotel industry is made up primarily of small establishments. While our association represents the great preponderance of all hotel rooms in the Nation, 88 percent of our member properties have 100 rooms or less, and 72 percent of our member hotels have 50 rooms or less. The profits of these establishments depend on the ability and hard work of the operators much more than on the capital invested in the business. You will not want to enact a tax law which is so burdensome that it discourages initiative and enterprise.

Whether you ultimately favor increased personal and corporate tax schedules, or whether you elect to broaden the excise tax base, or impose additional manufacturers' or retail sales taxes, will be for you to determine after these lengthy hearings which you are currently conducting. To go too far to raise any of these levies excessively, however, is sure to impair initiative and risk capital and jeopardize efficiency of business.

Let me devote this brief statement to some of the problems peculiar to our industry, which we hope you may have in mind as you approach any type of increased levies.

RETROACTIVITY

The suggested retroactivity of the income-tax features of this tax bill to some date early in 1951 might well mean grave inequities to those elements of business which, like ours, are currently under price ceilings. All the sales of food and beverage, and all the services within our hotels, except for our flower shops, and except for room rates, are currently frozen to January 25 ceilings, or to a percentage mark-up, based on a year or two ago. When you consider that, according to the annual report of Horwath & Horwath, hotel earnings in 1950 were only 5.66 percent after income taxes, you will see that any retroactive tax levy could be extremely burdensome. Unlike many industries, our volume of business, nationally, has continued to decline ever since 1944, so we could be squeezed badly if any form of tax were increased unduly.

EXCISE TAXES

The hotel industry has long been subjected to more excise taxes than any other industry known to us. Also we are an industry which is a heavy consumer of items which carry excise taxes, such as silverware, light bulbs, kitchen equipment, commercial vacuum cleaners, and heating and refrigerating equipment. This has brought into being many irritating situations. Let me invite your attention to some of these.

We fail to understand the logic whereby the Congress, in 1946, repealed the 15 percent transportation tax on foreign travel, but continued the imposition of this levy on domestic travel. Travel from our northern, southern, eastern, and western boundaries in America is thus encouraged to foreign ports, and discouraged within the continental boundaries. I think the Congress should be consistent in this, and either restore the tax on foreign travel, or repeal the levy on domestic travel.

It is now proposed to increase the Federal levy on alcoholic beverages from $9 to $10.50 a gallon, and on beer from $8 to $9 a barrel, with commensurate increases on wines of about 12½ percent ad valorem. The June issue of Changing Times, the news magazine published by Kiplinger, in Washington, reports the fact that there is already more bootleg liquor being sold in the United States than the supply which is marketed through legal channels. Without any doubt, every increase in these levies encourages illegal manufacture and sale of alcoholic beverages, beer, and wine. This can take place not only on a highly organized level, but also on a very small scale by individuals who are tempted by the differential in price between legal and illegal liquor. Without doubt, the increases in taxes on alcoholic beverages proposed in the House bill would spell diminishing returns to the Federal Treasury, as well as contributing to the moral turpitude of employees in many lines of business.

Some of the principles above enunciated have been borne out in the cabaret tax, which still stands at 20 percent. When this levy was reduced from 30 percent, in 1944, the Federal income jumped substantially. At the same time, the 20 percent levy has encountered so much guest resistance that more than half of the dine-and-dance rooms in hotels have been obliged to discontinue entertainment, thereby causing unemployment of musicians, waiters, and so forth.

Also, the 10 percent tax on oil, gas, and electrical equipment, and refrigerators and air-conditioning equipment which a hotel buys for its kitchen or other parts of the house comprise a tax on the tools of this business. Unless or until a general manufacturers' tax is imposed on all manufactured goods, the present excises comprise a discriminatory type of levy, and will continue to be burdensome upon those businesses, such as ours, which are heavy consuming industries. Exempt lines of manufacturer's products enjoy favored economic position and opportunities, which is not consistent with the American philosophy.

Further, it is conservatively estimated that 10 to 25 percent of the time of the clerical staff in certain departments of a hotel is required for the handling of the records covering taxes on individual guest accounts, and for billing. An illuminating illustration comes from one hotel in Washington, D. C., which made 91,748 computations last year, involving the excise tax on communications alone. Further, there were 3,455 guest checks upon which the cabaret tax was applicable for a single month. This would mean approximately 41,460 such computations for a year. Incidentally, this particular hotel, which is a member of a chain operating in seven cities, shows that for 1949 local, State and Federal taxes accounted for total levies equivalent to $578.17 per room per year. Even this sum does not include liquor licenses, excise taxes, or local or State sales or use taxes. But even this sum means a tax overhead of $1.58 per guest room per day, regardless of whether the guest room is occupied or empty.

Not only is the burden of this computation excessive, but where a long list of employees works on records which involve tax calculations, we are constantly vulnerable since some innocent error may occur on the part of some one employee which can mean a tax liability upon the hotel. We know that whenever an error occurs in computing the tax on a guest's telephone and telegraph bill, and the proper amount is not collected from the guest at the time he checks out, the hotel is stuck.

SECTION 22 (B) (9) OF THE REVENUE CODE

There is now pending before your committee H. R. 2416, which would make permanent in the Revenue Code that provision which the Congress has renewed annually for the past 4 years. This section excludes from gross income, in the case of a corporation, the amount of income attributable to the discharge of indebtedness evidenced by a bond, debenture, note, certificate, or other evidence of indebtedness. In the event an amount is excluded from gross income under this provision, a reduction is made in the cost basis of the corporate property upon which depreciation is taken. Although this results in a mere postponement of tax liability, not an exemption, I believe that the Federal Government should continue to offer this small inducement to a corporation to reduce its outstanding indebtedness.

VIRGINIAN HOTEL CORP. CASE

Hotels generally have been deprived of a substantial amount of surplus capital credit during the past 6 years as a result of the 5 to 4 decision of the Supreme Court in the Virginian Hotel Corp. case (319 U. S. 523). Under that decision, whenever it is determined that depreciation has been taken at an excessive rate, and/or life of an asset extended, the adjusted basis of the asset is reduced by the excess depreciation taken even though the taxpayer received no tax benefit therefor.

For many years the hotel industry was guided entirely by the recommendations of the Bureau of Internal Revenue, as published in bulletin (F). But when the Commissioner departed from the principles set forth therein, and saw fit to disallow a recovery of excessive depreciation, even though taken innocently and erroneously, hotels, and other business establishments affected by such circumstances, were penalized. The position which the Commissioner has taken has the effect of allowing the taxpayer a high depreciation deduction when he has no income, and a smaller depreciation when he has income to be offset thereby. It is unfortunate that a taxpayer must reduce his fixed asset base period at all when he has no profits; but when the reduction is at a rate in excess of the rate subsequently determined as acceptable by the Treasury Department, an even greater hardship results.

This principle is present in hotels generally these days, because when originally built, most hotels elected to set up a 30- to 40-year useful life, for purposes of depreciation, in connection with income-tax returns. Now the Commissioner is coming along and extending the useful life of those properties, and thus bringing to light many instances when excessive depreciation was taken. The effect of H. R. 3168, which is currently before your committee, is to provide that the adjusted basis of property is to be reduced by excessive depreciation shown in a return only to the extent that such excessive depreciation resulted in a reduction in taxes. We hold that this is an eminently fair provision, and must be enacted if the inequities resulting from the Supreme Court decision, and from the Commissioner's departure from bulletin (F), are to be removed.

SUGGESTED AID TO SMALL BUSINESS

The hotel industry, as stated earlier, is essentially an industry consisting of many small units. According to the 1948 Census of Business, of the total number of hotels enumerated, 29,650 (about 88½ percent) have fewer than 100 rooms. Of the total number of hotels in the country, a little more than 5,000 are operated by corporations, and of these, more than 3,000 have fewer than 100 rooms. In other words, the hotel industry includes more than 3,000 small corporations owned and controlled by one, or not more than a few persons. These men operating small businesses should have the advantages and protection of operating their businesses as corporations, but often our income-tax laws make them pay a very heavy price for that privilege.

In order to protect these small corporations and avoid the dissolution of many of them, the hotel industry urges that the owners of any small corporation, if the number of such owners is not more than five, be given the right to file their income-tax returns as a partnership, under rules and regulations to be prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. We think that this should be a permanent provision of the Internal Revenue Code.

Such a provision would not only give thousands of small-business men a protection which they can enjoy only at a heavy cost in taxes in many cases, but also would simplify the taxation of these small businesses. There would be no longer any questions arising as to the reasonableness of salaries drawn by such officers, the deductibility of charitable contributions made through their business bank accounts, nor would there be any question of whether the surplus accumulated in the business is reasonable or unreasonable.

This could be readily accomplished by amending the income-tax sections and the excess-profits tax sections of the Revenue Code.

CLOSING LOOPHOLES

May I next direct your attention to section 422 of the 1950 Revenue Act. We pay high tribute to your committee for including in last year's tax law a provision which taxes the unrelated business activities of certain tax-exempt groups.

The Secretary of the Treasury testified last year that 5 percent of gross retail sales in the country are now being transacted by tax-exempt establishments. We know that in our field there is a growing volume of food and beverage business being done by tax-exempt groups in direct competition with taxpaying hotels and restaurants. We do not propose that any tax-exempt establishment be barred from furnishing food and drink, or housing, to their own members. But at the moment some of those organizations openly bid for the patronage of large public groups, for profit, and we contend that they are thereby sacrificing their immunity, under the spirit of the tax laws.

Congress did require last year, for the first time, that those tax-exempt establishments coming under paragraphs 1, 6, 7, and 14 of section 101 of the code be made subject to the act. We have been working with the Division of Tax-Exempt Organizations of the Treasury Department subsequent to the passage of this act, and find that the new reporting forms which are now being developed will insure a reasonable degree of compliance by the affected organizations.

But we do respectfully suggest that the flat exemption now being accorded fraternal and social organizations under the code should be reviewed. If it is proper to cover under the Federal income-tax laws some tax-exempt organizations, we believe it is sound to cover all of them. As the Federal tax levy increases, percentagewise, a disproportionate volume of business can flow to those establishments which continue to enjoy an exemption. As an example, in some communities, fraternal and social clubs are the worst offenders, when it comes to catering to public groups, for profit, in the furnishing of lodging, luncheons, banquets, and other food and beverage services. And yet these groups are specifically exempt under the code.

The Bureau of Internal Revenue tells us that even though a fraternal organization is doing a substantial amount of public business, for profit, in competition with taxpaying establishments, the Treasury cannot assess that corporation. The only thing they can do is to come to that corporation, confront them with the evidence of these frequent public functions, and ask them to either terminate such practices or sacrifice their tax-exempt status. We contend that the Treasury is thus waiving prospective Federal revenue by continuing a specific exemption of such groups and permitting them to go right ahead engaging in profitable activities, through catering to the general public.

We do especially urge that a study be made of this situation, and that the second step be now taken toward exposing all tax-exempt organizations to Federal income tax when it is found that they are frequently engaging in the service of food or lodging to large public groups, entirely foreign to their own membership.

SECTION 123 OF H. R. 4473

This provision would attempt to limit a group of related corporations to a single surtax exemption and a single minimum excess-profits credit. Although it is conceivable that in some instances corporate groups are now able to reduce tax liabilities under existing statutes, adoption of this provision would disregard corporate entities and increase corporate taxes merely because their stockholders were also stockholders of other corporations.

It has been pointed out by Treasury spokesmen that adoption of this section would simplify administrative procedures in checking related corporate groups. In many cases these corporate groups may have been in existence for a long period of time, and it might easily prove highly inequitable to compel them to dissolve because of this new proposal.

As I emphasized earlier, the hotel industry is essentially an industry of small establishments. My own chain of hotels is a good illustration. I have seven hotels, located in six different cities in the State of Ohio. Each of these hotels is subject to vicissitudes of weather, general business conditions, acts of God, and the general whims of the traveling public. It is conceivable that in any given year some of the hotels might prove profitable, whereas others would lose money. I have felt that it would be eminently unwise to demand that any one or two hotels should carry the load for other establishments which went into the red. As a matter of fact, if one of my hotels should lose money consistently over a period of time, and if I could not devise methods by which it could be converted into a profitable operation, the sooner I could sell such an establishment the better. And, if such an establishment were incorporated separately, the sale of the property would be simplified.

Hotels are service establishments. It matters not what brick, steel, or mortar goes into a hotel building. Unless the establishment maintains a level of service that is pleasing to the patrons, it will not succeed. Providing that personal service is the everlasting test of good management. There is an old saying in our industry, "Two hotels, two headaches." There is no doubt in my mind but that the adoption of this section 123 of the House bill will discourage hotel men from venturing risk capital and undertaking the obligations involved in providing a high level of service in more than one establishment. It would certainly open the door, also, for other tax-evasion practices, thus defeating the purpose for which the amendment is designed.

There are certain advantages which come from owning and operating more than one establishment. These embrace group purchasing, specialized legal and accounting standards, training of key staff people to take over other establishments, and so forth. But these might be outweighed by the requirement that all such related groups be brought under a single corporate tent for tax purposes. I think clearly the proposal would retard business growth and expansion. And I conceive this to be out of step with the well-considered tax legislation normally enacted by your committee.

INCREASE ON TAX ON RETAIL LIQUOR DEALERS

Section 461 of H. R. 4473 proposes to increase the occupational tax on retail dealers in liquors from $27.50 to $50 a year. There appears to be no justification for such a substantial increase in tax. This tax has never been designed for revenue-producing purposes but is in the nature of a regulatory license, and the amount is obviously designed to cover expenses of administration only. The hotels having liquor licenses already pay heavy license fees to State authorities, and if the beverage industry is to contribute higher taxes to the Federal Government it will do so under the provisions of sections 451, 452, and 453, reference to which is made above. Even during World War II this occupational tax on retail dealers in liquor was increased only from $25 to $27.50, and there appears to be no justification for practically doubling the tax by raising it to $50 at this time.

Senator BYRD. In lieu of an appearance, the Chair inserts into the record at this point a letter dated July 24, 1951, from W. A. Mogensen of Avco Manufacturing Corp., together with a memorandum.

(The documents referred to follow:)

AVCO MANUFACTURING CORP.,
New York, N. Y., July 24, 1951.

Senator HARRY F. BYRD,
Acting Chairman, Senate Committee on Finance,
Washington, D. C.

DEAR SENATOR BYRD: As suggested in your letter of July 19, 1951, I wired you waiving the time allotted to me so as to expedite completion of the public hearings.

My request for appearance was to point out to the United States Senate

Finance Committee a provision of the present excess-profits-tax law which discriminates unfairly against companies such as Avco Manufacturing Corp., and gives certain other taxpayers an unfair advantage. I am submitting herewith for the committee's consideration a memorandum which describes the operation of this provision in some detail and contains the draft of a simple amendment to the law which removes the inequity and, at the same time, very much simplifies the law.

My company, Avco Manufacturing Corp., like many other taxpayers, computes its excess-profits credit on the average-income method. Under this method the taxpayer uses as the basic measure of normal profits 85 percent of the average income for the three best years in the base period. To this average income the taxpayer is allowed to add a credit for increases in capital during the last 2 years of the base period. An adjustment is also made for capital additions and reductions subsequent to the base period. In general, capital additions and reductions consist of changes, up or down, in paid-in capital, earned surplus, borrowed capital, and in so-called inadmissible assets; that is, investments in the stock of other companies.

The inequity is in the treatment of changes in inadmissible assets. In figuring the capital addition for the last 2 years in the base period, an increase in inadmissible assets is treated as a capital reduction, and a decrease in inadmissible assets is treated as a capital addition. However, in figuring post-base-period capital additions or reductions, changes in inadmissible assets are not specifically allowed as capital additions or reductions, but are given only the limited effect of offsetting other kinds of capital changes. This, I sincerely believe, is illogical, inconsistent, and inequitable.

Let me use the experience of my company, Avco Manufacturing Corp., as an illustration. At December 1, 1949, the beginning of our first excess-profits-tax year, we had inadmissible assets (stock investments in other companies) of some $10,500,000. During 1950 and early 1951 we sold practically all of our marketable stock investments aggregating some $12,000,000 to obtain additional working capital for our manufacturing business, as very substantial defense work has been superimposed on our normal civilian production. In other words, we sold assets which produced income exempt from excess-profits tax and invested the proceeds in manufacturing assets which are now producing income fully subject to excess-profits tax. Yet we are allowed no increase in our excess-profits credit, because the present law does not treat such post-base-period decreases in inadmissible assets as a capital addition. If we had retained our investments, and had borrowed the equivalent amount of our defense contract and other manufacturing requirements, we would have obtained an increase in our excess-profits credit. There is no good reason why sale of our inadmissible assets should not increase our excess-profits credit, particularly since we are using our own resources instead of burdening the national credit structure by unnecessary borrowings.

Furthermore, if we had sold our $12,000,000 of investments on November 30, 1949, or prior thereto, we would have been allowed a capital addition. This is because the law treats decreases in inadmissibles as capital additions during the base period but not during the taxable year. There is no logic whatever in treating a sale of inadmissibles in 1950 differently from a sale in 1949. If anything, the sale of inadmissibles in current years should be treated more favorably to the taxpayer, not less, especially where, as in my company's case, the effect of such a sale is to provide private working capital for the national-defense effort.

This and other inequities in the present provision regarding inadmissible assets are covered in the memorandum which I am submitting for your consideration. I might add that this memorandum has been considered by the Federal taxation committees of the American Institute of Accountants and of the New York State Society of Certified Public Accountants, and that the suggested amendment has received their full approval. I understand that this approval is covered in separate statements which they are submitting to your committee at these hearings.

The proposed amendment, which would greatly simplify Internal Revenue Code section 435 (g) merits, in our opinion, favorable consideration.

Sincerely yours,

AVCO MANUFACTURING CORP.
W. A. MOGENSEN,
Vice President and Treasurer.

NECESSITY FOR A TECHNICAL AMENDMENT OF THE 1950 EXCESS PROFITS TAX ACT TO AFFORD EQUITABLE TREATMENT TO TAXPAYERS HAVING CHANGES IN INADMISSIBLE ASSETS SUBSEQUENT TO THE BASE PERIOD

Under the 1950 Excess Profits Tax Act, in the case of a taxpayer computing its excess-profits credit under the income method, changes in inadmissible assets during the last 2 years of the base period are used in the computation of base-period capital additions and reductions and accordingly increase or decrease the excess-profits credit. However, under the act changes in inadmissible assets subsequent to the base period do not constitute capital additions or reductions (except to a very limited extent, i. e. reductions in inadmissibles are subtracted from capital reductions and increases in inadmissibles are subtracted from capital additions). There does not appear to be any logic or equity in the fact that post-base-period changes in inadmissibles are not to be considered as capital additions and reductions by themselves.

This provision of the present act adversely affects any taxpayer computing its excess-profits credit under the income method (and not having a capital reduction after December 31, 1949) if it had substantial investments in 1949 which it disposed of in 1950 or 1951 in order to obtain additional working capital to finance expanding manufacturing operations, including defense contracts. Such taxpayer's increased earnings resulting from the additional working capital employed in manufacturing operations are, under the present act, treated entirely as excess profits and taxed accordingly. This is for the reason that the taxpayer receives no additional excess-profits credit for the funds transferred from inadmissible assets, the income from which was exempt from excess-profits tax, to manufacturing operations, the income from which is subject to excess-profits tax. If the taxpayer obtained the additional working capital for manufacturing operations by sale of its own securities or by borrowings, it would otbain an increase in excess-profits credit. For such a taxpayer not to receive an additional excess-profits credit on additional working capital obtained from disposal of inadmissible assets is clearly inequitable and illogical. Conversely, a taxpayer which disposed of a portion of its operating assets in 1950 or 1951 and invested the proceeds in inadmissible assets suffers no reduction in excess-profits credit, even though its income subject to excess-profits tax has been substantially reduced by means of this transfer, and its excess-profits credit should, in equity, be reduced.

To illustrate the above in the form of a concrete example, assume that throughout the base period Company A and Company B were engaged in the same kind of business, had the same taxable net income from regular business operations, and had the same amount of business net assets which aggregated $1,000,000 for each company at December 31, 1949. Assume, however, that Company A also had $500,000 of stock investments. At January 1, 1950, the excess-profits credit based on income would be the same figure for each company, since the dividend earnings on Company A's stock investments do not enter into the computation of the credit. Assume that this excess-profits credit is $200,000 for each company. Now assume that on January 2, 1950, Company A sells its stock investments and uses the proceeds to buy $500,000 of additional business assets, and that Company B sells $500,000 of its business assets and uses the proceeds to purchase stock investments. Assume there were no capital additions or reductions for either company during the remainder of the year 1950. Under the present law the excess-profits credit of each company remains at $200,000. Company B will undoubtedly have no excess-profits tax liability for 1950, and will in fact have an unused excess-profits credit, since it has only half the amount of business assets which it had in the base period, and the dividend income from its stock investments is exempt from excess-profits tax. Company A will have a very large excess-profits tax, because its business assets have increased 50 percent with no corresponding increase in excess-profits credit. Company A, which has assumed new burdens of production, employment, and contribution to the national economy and defense, is penalized by the excess-profits tax, while Company B is rewarded with a tax exemption for relieving itself of those same burdens.

An additional inequity in this provision is that it applies only to the excess-profits credit under the income method. Under the invested-capital method all changes in inadmissible assets are fully reflected in the excess-profits credit. In the above example, Company A's invested-capital credit would be increased and Company B's invested-capital credit decreased, for the changes in inadmissible assets. The base-period income and invested capital provisions are therefore conflicting in this respect under the present law.

Attached is a draft of a proposed amendment to section 435 (g) of the Internal Revenue Code, which remedies the defects discussed above. The amendment provides that increases in inadmissible assets shall constitute capital reductions and decreases in inadmissible assets shall constitute capital additions. This is accomplished by the addition of two short sentences (sec. 435 (g) (3) (D) and sec. 435 (g) (4) (E) in the attached draft), and the deletion of a large amount of material which is superfluous, since these deleted provisions deal with special situations which are adequately covered by the proposed rule. The resulting simplicity of section 435 (g) is in itself an additional reason for adoption of the amendment as the present section 435 (g) and its effect on the regulations and excess-profits tax return form are unnecessarily complicated, confusing to taxpayers, and difficult of administration.

Draft of Proposed Amendment to I. R. C. Section 435 (g)

[Matter enclosed in black brackets indicates portion of existing law to be deleted by amendment; matter italicized indicates portions to be added by amendment]

(g) Net Capital Addition or Reduction

(1) Net capital addition.—The net capital addition for the taxable year shall, for the purposes of this section, be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital addition for each day of the taxable year over the aggregate of the daily capital reduction for each day of the taxable year. [If there is an increase in inadmissible assets for the taxable year, determined under paragraph (5), the net capital addition shall be the excess of the amount determined under the preceding sentence over

[(A) unless subparagraph (b) is applicable, the amount of such increase in inadmissible assets;

[(B) if the amount of such increase in inadmissible assets is in excess of the net capital addition determined without regard to this sentence and without regard to paragraph (3) (C), the amount of such increase in inadmissible assets minus 25 per centum of such excess.]

(2) Net capital reduction.—The net capital reduction for the taxable year shall, for the purposes of this section, be the excess divided by the number of days in the taxable year, of the aggregate of the daily capital reeduction for each day of the taxable year over the aggregate of the daily capital addition for each day of the taxable year. [If there is a decrease in inadmissible assets for the taxable year, determined under paragraph (5), the net capital reduction shall be the excess of the amount determined under the preceding sentence over

[(A) unless subparagraph (B) is applicable, the amount of such decrease in inadmissible assets,

[(B) if the amount of such decrease in inadmissible assets is in excess of the net capital reduction determined without regard to this sentence and without regard to paragraph (4) (C) and (E), the amount of such decrease in inadmissible assets minus 25 per centum of such excess.

(3) Daily capital addition.—The daily capital addition for any day of the taxable year shall, for the purposes of this section, be the sum of the following:

(A) The aggregate of the amounts of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, after the beginning of the taxable year and prior to such day.

(B) The amount, if any, by which the equity capital (as defined in section 437 (c)) at the beginning of the taxable year exceeds the equity capital at the beginning of the taxpayer's first taxable year under this subchapter.

(C) 75 per centum of the amount, if any, by which the average borrowed capital for the taxable year (as defined in section 439 (a)) exceeds the daily borrowed capital for the first day of the taxpayer's first taxable year under this subchapter.

(D) The decrease in inadmissible assets for such day, determined under paragraph (5).

(4) Daily capital reduction.—The daily capital reduction for any day of the taxable year shall, for the purposes of this section, be the sum of the following.

(A) Distribution to shareholders previously made during such taxable year which are not out of the earnings and profits of such taxable year; and

(B) The amount, if any, by which the amount of the equity capital (as defined in section 437 (c)) at the beginning of the taxpayer's first taxable year under this subchapter exceeds the amount of the equity capital at the beginning of the taxable year; and

(C) 75 per centum of the amount, if any, by which the daily borrowed capital (as determined under section 439 (b)) for the first day of the taxpayer's first taxable year under this subchapter exceeds the average borrowed capital for the taxable year; and

[(D) The amount determined under paragraph (6), relating to increase in certain inadmissible assets by a member of a controlled group; and]

[(E)] *(D)* 75 per centum of the amount determined under paragraph [(7)] *(6)*, relating to increase in loans to a member of a controlled group.

(E) The increase in inadmissible assets for such day, determined under paragraph (5).

(5) Definitions with respect to inadmissible assets.—For the purpose of this subsection—

[(A) Average inadmissible assets for the taxable year. The average inadmissible assets for any taxable year shall be the total of the daily amounts attributable to the inadmissible assets for such taxable year, determined under section 440 (b), divided by the number of days in such taxable year.]

[(B)] *(A)* ORIGINAL INADMISSIBLE ASSETS.—The term "original inadmissible assets" means the total of the inadmissible assets for the first day of the taxpayer's first taxable year under this subchapter, determined under section 440 (b).

[(C)] *(B)* INCREASE IN INADMISSIBLE ASSETS.—The term "increase in inadmissible assets" for any *day of the* taxable year means the excess of the [average] inadmissible assets for such *day* [taxable year] over the original inadmissible assets.

[(D)] *(C)* DECREASE IN INADMISSIBLE ASSETS.—The term "decrease in inadmissible assets" for any *day of the* taxable year means the excess of the original inadmissible assets over the [average] inadmissible asset for such [year] *day.*

(6) CONTROLLED GROUP.—If, on any day of the taxable year, the taxpayer and any one or more other corporations are members of the same controlled group, the amount added to the daily capital reduction under paragraph (4) (D) shall be whichever of the following amounts is the lesser:

[(A) The excess of the aggregate of the adjusted basis (for determining gain upon sale or exchange) of stock in such other corporation (or if more than one, in such other corporations) held by the taxpayer at the beginning of such day over the aggregate of the adjusted basis (for determining gain upon sale or exchange) of stock in such other corporation (or if more than one, in such other corporations) held by the taxpayer at the beginning of its first taxable year under this subchapter; or

[(B) The excess of the aggregate of the adjusted basis (for determining gain upon sale or exchange) of inadmissible assets held by the taxpayer at the beginning of such day, over the aggregate of the adjusted basis (for determining gain upon sale or exchange) of inadmissible assets held by the taxpayer at the beginning of its first taxable year under this subchapter.

The increase in inadmissible assets for the taxable year shall, for the purpose of paragraph (1), be determined by reducing the inadmissible assets for such day by the amount by which the daily capital reduction for such day is increased under this paragraph. As used in this paragraph, a controlled group means one or more chains of corporations connected through stock ownership with a common parent corporation if (i) more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock, of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations and (ii) the common parent corporation owns directly more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of the shares of all classes of stock, of at least one of the other corporations.]

[(7)] *(6)* LOANS TO MEMBERS OF A CONTROLLED GROUP.—If, on any day of the taxable year, the taxpayer and any one or more other corporations are members of the same controlled group, [as defined in paragraph (6)], the amount referred to in paragraph (4) [(E)] *(D)* shall be the excess of the amount of the indebtedness of such other corporation (or if more than one, such other corporations) to the taxpayer at the beginning of such day over the amount of the indebtedness by such other corporation (or if more than one, such other corporations) to the taxpayer at the beginning of such day over the amount of the indebtedness by such other corporation (or if more than one, such other corporations) to the taxpayer at the beginning of its first taxable year under this subchapter. For the purposes of this paragraph, the term "indebtedness" means indebtedness which constitutes daily borrowed capital, as defined in section 439 (b) (1), of such other corporation for such day.

As used in this paragraph, a controlled group means one or more chains of corporations connected through stock ownership with a common parent corporation if (i) more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock, of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations and (ii) the common parent corporation owns directly more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of the shares of all classes of stock, of at least one of the other corporations.

[(8)] (7) CROSS REFERENCE.—For special rules applicable to this subsection see section 441.

NOTE.—Cross references to portions section 435 (g) contained in other sections of the Code will also require change.

Senator BYRD. The Chair inserts into the record at this point a statement as requested by Senator Hill of Alabama, submitted by Stuart Hedden, president of Wesleyan University Press.

(The document referred to follows:)

STATEMENT OF STUART HEDDEN, PRESIDENT OF WESLEYAN UNIVERSITY PRESS

Wesleyan University Press has had an application for exemption from income taxation under the provisions of section 101 (6), Internal Revenue Code, pending before the Treasury Department for over a year. The Treasury is uncertain as to the intentions of Congress in title III of the Revenue Act of 1950 and this memorandum is submitted in the belief that a clear statement from the Senate Finance Committee to the Treasury with respect to this question will assist Wesleyan University Press in obtaining without litigation an exemption it believes it is entitled to under the law.

WESLEYAN UNIVERSITY

Wesleyan University, founded in 1831, has long been distinguished as one of the outstanding privately endowed liberal arts colleges of the country. Popularly known, together with Williams and Amherst, as one of the Little Three colleges of New England, it has for nearly a century and a quarter served the public welfare by maintaining with traditional integrity the highest academic standards. It is nonsectarian, and its alumni in peace and war have served their country and communities in teaching, in government, in the military services, in the pulpit, in the sciences, and in business. Woodrow Wilson taught there. President William Howard Taft and his Secretary of State, Elihu Root, participated in the inauguration of one of its Presidents. Wesleyan is proud of a distinguished tradition and submits that its determination of what is a related educational activity should not be lightly considered.

WESLEYAN UNIVERSITY PRESS

On September 9, 1949, Wesleyan University acquired by purchase under a 10-year installment contract with a down payment of $400,000 from its own funds, the entire outstanding capital stock of three closely interrelated and singly operated educational publishing enterprises, which were immediately dissolved and the assets of which were immediately vested in the Wesleyan University Press, Inc., a nonstock membership corporation formed under a provision of Connecticut law not available to mercantile or commercial corporations for profit. The Treasury found the price reasonable in approving the seller's application for a ruling that the sale constituted an installment capital gain.

The incorporators of Wesleyan University Press were all members of the Board of trustees of Wesleyan University and alumni of the college, as are the members of the board of trustees of Wesleyan University Press. The purposes of this corporation are set forth in article 2 of its articles of association, the dominant purpose being stated in article 2a "to conduct and carry on the work of the corporation, not for profit, but exclusively for charitable, scientific, literary, and/or educational purposes, including educational research." The purposes do not include engaging in a general publishing business. Such activities as are authorized are stated explicitly to be subject always to the provisions of articles 2a and 2c which expressly limits any publishing activity to educational publications. The articles of association further specify that no part of the net earnings or property of the corporation shall inure to the benefit of any individual or to the benefit of any corporation other than Wesleyan University; that in the event of dissolution, cessation of operations, or the like, all net assets of the corporation shall be distributed to Wesleyan University; and that the corporation shall not in any way engage in carrying on propaganda or in attempting to influence legislation. The bylaws specifically provide that no trustee of the press and no officer who is such a trustee shall receive any remuneration. A resolution of the board of trustees of the college provides that all successor trustees of the press must be nominated by the board of trustees of the college.

PUBLICATIONS OF WESLEYAN UNIVERSITY PRESS

All the publications of Wesleyan University Press are educational in the strictest sense of this term. The Press publishes a series of graded weekly periodicals (My Weekly Reader, Current Events, Current Science and Aviation, Our Times) for classroom use in elementary and high-school classes, together with teachers' aid papers to assist teachers in the proper use of these publications. It also publishes (to the extent of approximately 8 percent of its income) classroom text and work books, largely paper-bound and consumable. It publishes all the official publications of Wesleyan University, including its Alumni News, which is mailed free quarterly to over 8,000 alumni, and is embarking upon the publication of scholarly works of the Wesleyan faculty. It does no business whatsoever with the general public; all of its publications are sold directly and in bulk and delivered to classrooms or boards of education. It accepts no advertising, does not employ advertising agents (14 university presses do), does not sell to book stores or book jobbers, and in this sense does not compete in any way whatsoever in the normal channels of distribution of the publishing business. At the time of its acquisition by Wesleyan University, 75 percent of its income was derived from publications which had no competition whatsoever from private industry or otherwise, although since its acquisition by the university some slight competition has arisen in this field. Among its principal book publications are the Little Wonder Books, 90 titles edited on six distinct levels of reading difficulty. These are the only graded series of booklets interpreting the contemporary world to school children in language they can read for themselves. This feature was inaugurated in 1932 at the suggestion of Charles H. Judd, chairman of the College of Education of the University of Chicago (and incidentally a Wesleyan graduate). Dr. Judd thought this project was so important that educational foundations should subsidize it if necessary.

Another of the Press publications, the current events paper Our Times, is the outgrowth of Uncle Sam's Diary, founded by David Lawrence in 1931 and published by a nonprofit philanthropic organization known as the United States Society which was supported by substantial charitable donations from 1931 to 1937. It was published during part of this time by the School of Public Affairs of American University in Washington, D. C. Its then editor, Arthur S. Fleming, is presently Director of Manpower Mobilization under Mr. Charles E. Wilson. In 1937, at Mr. Fleming's initiative, Uncle Sam's Diary was merged with Our Times, then privately published by our predecessor. It, of course, lost its tax-free status at this time when its profits inured to private individuals, but now that it is published by Wesleyan University Press it and the other publications of which it is typical should clearly again be tax exempt.

WESLEYAN PRESS PUBLICATIONS WIDELY RECOGNIZED AS EDUCATIONAL

The Treasury itself has found Wesleyan Press publications to be educational. In a letter from the Commissioner of Internal Revenue to the Press dated May 16, 1950 (which denied the Press exemption under the then policy of denying all exemptions pending the enactment of the 1950 law), it was stated:

"Your activities consist of composing, compiling, editing, illustrating, printing, and publishing educational books, periodicals, and miscellaneous other materials instructional and educational in character. Your principal publications are books and weekly periodicals prepared in conformity with standards of leading educators, designed for distribution to teachers, pupils, and schools, and are used mainly in classroom work in the elementary schools."

Top-ranking educators have long recognized the importance of the educational services of publishers of current events papers. The following quotation is from Msgr. Frederick G. Hockwalt, director of education of the National Catholic Welfare Conference:

"Inasmuch as our form of government is predicated on the existence of an informed and intelligent electorate, interest in current problems must be fostered during the formative years. * * * The Commission believes that the classroom use of carefully edited current events periodicals * * * is essential to effective instruction in the social studies and to training for good citizenship."

Dr. Stanley Dimond, president of the National Council for the Social Studies says in the January 1949 issue of Social Education:

"One of the greatest gains of the past 25 years (in the schools) has been the increased attention given to the study of current affairs * * * adequate recognition has not been given in this country to those who have helped us by publishing current events materials for the schools."

Dr. Joy Elmer Morgan, editor of the National Education Association Journal, and Director of the Division of Publications of the National Education Association, in a statement before the House and Senate Committees on Postal Rates in 1949 said:

"Our schools are benefiting greatly by the use of periodicals designed for classroom use in current affairs and civic education, such as The American Observer, The Scholastic, American Education Press, and so on."

American Education Press is a predecessor of Wesleyan University Press. Dr. Morgan was urging special postal rates for these publications because of their educational value.

APPLICATION ON THE REVENUE ACT OF 1950

It is submitted that in passing the Revenue Act of 1950, Congress clearly intended to exempt from taxation income of such educational activities as university presses conduct. In presenting this act to their respective Houses, Senator George as Chairman of the Finance Committee of the Senate and Representative Doughton as Chairman of the Ways and Means Committee of the House, each specifically stated in commenting on what constituted a related activity, that the income of a university press in the usual case would be exempt. The Treasury has apparently found difficulty in interpreting this intention, partly it is believed because there is no such thing as a "usual" university press. The most comprehensive study of university presses ever made is a publication by Kerr published in 1949 under a grant from the Rockefeller Foundation. Kerr's second chapter is entitled "What Is a University Press?". His conclusion at the end of this chapter (p. 14 of his book) is: "But while large or small, African or Indian, an elephant resembles an elephant, a university press does not always resemble a university press. To paste up a composite picture of the latter would only produce a creature that does not really exist." In fact, Kerr found it impossible even to classify the interests of the university presses reviewed and had to list each separately. It is a fact that universities historically have established presses to carry out whatever interest the university in question considered appropriate. Some publish strictly scholarly works, some publish literary reviews scarcely distinguishable from such reviews as The Atlantic Monthly and Harpers magazine—The Kenyon Review, for example. Some publish popular novels. The mainstay of the Chicago University Press is the Bible. Loyola University Press publishes nothing but textbooks for use in Catholic elementary schools, high schools, and colleges. Harvard University Press offers a wide catalog of popular literature. North Carolina Press publishes such popular books as Eleanor of Aquataine. Many best sellers, fictional and otherwise, have been university press books. Hayek's The Road to Serfdom, of the Chicago University Press is an appropriate example. The fact is that the Wesleyan University Press is the only one in the country (possibly excepting Loyola) whose publications which are sold are used entirely by students in their classroom education.

The primary test of exemption under the 1950 Revenue Act is whether the activity is substantially related to the activity of the exempt institution. It is submitted that if a strictly educational publishing activity of a college is interpreted as not being related to the activities of the college, this act has accomplished an unintended revolution. Wesleyan University, with full consciousness of the obligations imposed upon her as a tax-exempt institution, acting with an integrity born of a long tradition, has determined that she can extend her activities, perform a necessary and useful function in the educational world, and enhance her educational prestige and opportunities through the educational publications of the Wesleyan University Press. (Wesleyan has refused to purchase, on a very attractive basis, the leading Educational Directory, which although clearly educational, is not in our view "related" to our interests.) Wesleyan believes, however, that our liberal arts colleges have concentrated on their relations with the graduate schools to the neglect and exclusion of the educational field at the precollege level and that she has a useful, proper, and related function to perform in this field. That she chose to do so through the acquisition of a profitable enterprise in this field is immaterial to the question of whether this activity is related. This fact simply creates and enlarges the opportunity for service. It is clear from affidavits on file with the Treasury, from men whose integrity is beyond question (the president of the university and several distinguished trustees), that had Wesleyan not believed the activities of the Press to be supplemental to the fundamental purposes of the university its board would never have sanctioned the acquisition, regardless of financial considerations.

President Butterfield's affidavit stated, for example:

"I believe that anything the college can do to strengthen general education at the precollege level, and particularly in these fields (current events, civics, reading training), is vitally important and is definitely a proper function of the college. (From the point of view of the contribution the college can make to its own enrolled students, such work is infinitely more important than adult extension programs, for example.) As an educator, I have no reservation in stating my conviction that such activities are definitely related to the educational aims and purposes of Wesleyan University."

A Wesleyan faculty committee headed by Dr. Schattschneider is being employed to bring the ideas of the history, political science, English, and economics departments to bear on the policies of the Press. The English department of the college, headed by Prof. Wilbert Snow (former Connecticut Governor), is greatly concerned over the poor reading habits and skills exhibited by college students and is working with the Press on plans to make a contribution toward the improvement of secondary-school reading habits. Special faculty editors are being selected as advisory editors for each Press publication.

Wesleyan's interest in precollege education is by no means new, and far antedates its acquisition of the Press. President Butterfield and Dean Eldredge both came to college work after teaching in secondary-school systems, and have long evinced an active interest, working in conjunction with the Connecticut Department of Education for many years antedating the acquisition of the Press in improving standards of elementary- and high-school teaching. They share with most college educators a growing concern about the inadequate preparation of students applying for college admission, and believe that the ever-increasingly evident inadequacies go right back to defects in elementary-school teaching and standards.

The importance of the relationship of the college and secondary schools has long been recognized, particularly in New England. Wesleyan has for many years been a member of the New England Association of Colleges and Secondary Schools. And Wesleyan men have long been leaders and innovators in the field of precollege education. In fact, any list of the 10 or 12 most prominent contributors to this branch of education over the last 25 years would certainly include at least 6 Wesleyan men—Thorndyke, Judd, Inglis, Dearborn, Buckingham, and Freeman.

No one has ever questioned the propriety of the Elementary School Journal, published by Chicago University Press.

The Revenue Act of 1950 represents the first attempt in the history of American education to task any income of our colleges. If Congress did not intend by this act to restrict colleges from activities which they in good faith deem to be related and appropriate, such as Wesleyan has embarked upon in the Wesleyan University Press, it is the belief of the undersigned that an informal clarification from the Senate Finance Committee to the Treasury in this matter would be helpful in seeing that the intention of the Congress is carried out without the necessity of long, expensive litigation.

Senator BYRD. Mr. John B. Poole.

Please be seated and identify yourself for the reporter, Mr. Poole.

STATEMENT OF JOHN B. POOLE, TELEVISION BROADCASTERS TAX COMMITTEE

Mr. POOLE. Thank you, sir.

My name is John B. Poole. I am a practicing lawyer in Detroit, Mich., and, more particularly, am an officer, director, and stockholder of the Fort Industry Co.

The Fort Industry Co. is the owner and licensee of television stations located at Detroit, Mich.; Toledo, Ohio; and Atlanta, Ga.

It is also the owner and licensee of seven standard radio stations located in the three cities named, and also at Wheeling, W. Va.; Miami, Fla.; Fairmont, W. Va.; and Cincinnati, Ohio.

My appearance before the Senate Finance Committee is as a member of and spokesman for the Television Broadcaster's Tax Committee, an industry-wide group organized by the National Association of Radio and Television Broadcasters, and representative of the television broadcasting industry.

The committee serves a single purpose, that of petitioning the Congress to relieve the serious and critical financial plight of the television broadcasters under application of the excess-profits-tax law of 1950.

Our industry problem is essentially this: In December of 1945 the Federal Communications Commission first authorized commercial telecasting. Accordingly, it was during the base-period years, 1946 through 1949, that the industry, the radio industry, developed and pioneered television.

The impact of losses from television upon those radio broadcasters who undertook television activities was such that it depressed base-period normal earnings from radio, so as to leave us in the position today that roughly 50 percent of all of our normal earnings derived from radio are now taxed, under the excess-profits tax, and 100 percent of our earnings, present and future, in television will similarly be taxed under the act.

In other words, the credit which we have before the imposition of the excess-profits tax is representative of only the loss experience we sustained in television.

Now, the averages published by the Secretary show a return on capital of 24.9 percent in 1946 for radio broadcasting. There was some television broadcasting undertaken initially as a matter of pioneering in 1946 but of a very limited nature.

The average return proclaimed by the Secretary, however, in 1949 had declined to 10.1 percent. This average tells only a part of the story in the sense that it reflects normal earnings from several hundred broadcasters who had not yet engaged in television.

As far as those companies are concerned, which had pioneered television, our losses in the year 1949 in television actually exceeded the income which had been derived from radio broadcasting during the same year.

The Federal Communications Commission was good enough to make available at our request through Haskins & Sells, public accountants in New York, the industry figures and they have been compiled and analyzed by Haskins & Sells for our use in presentation to this committee.

It shows roughly that in 1946, 85 companies in radio broadcasting derived taxable income, net taxable income, of $14,800,000.

In that year, 59 of those 85 companies lost $851,000 in their initial undertakings in television.

Passing over to 1949 those same 85 companies lost $13,500,000 in television, while earning $12,500,000 approximately in radio broadcasting.

The average for the 4 years shows that instead of having a normal industry average of approximately $14,000,000 for radio broadcasting without reference to anything from television, our losses were such that our base credit is approximately $7,800,000 on an industry-wide average basis.

Under the excess-profits-tax law there is no relief. The invested-capital method of returning 12 percent on the initial investment is wholly inadequate for radio and television in any event.

Our norm in 1946 for radio broadcasting was 24.9 percent. The industry average for the base-period years, depressed by television losses, is 15.8, I believe.

The reason for that, of course, is capital is but one of a number of equally important income-producing factors in radio and television broadcasting.

Talent personnel, creative personnel, writers are equally important factors, but are not shown on our balance sheet and are not capitalized. The relief provisions which, if certain other qualifications are fulfilled, would permit us to relate our situation to the industry average, throws us back to the 15.8 percent which in effect merely reflects the impact of losses upon normal television earnings and leaves us nowhere.

We should like to mention that all radio and television stations are licensed by the Federal Communications Commission and are subject to their regulation.

I think our experience, our loss experience in 1949 showing that those——

Senator TAFT. Not as to price.

Mr. POOLE. I beg your pardon?

Senator TAFT. Not as to the price of advertising or——

Mr. POOLE. No; as to program standards, as to any number of standards, relating to our operations and, of course, you understand, that no person can broadcast or telecast until a license is first secured from the Federal Communications Commission.

Senator MILLIKIN. The license itself is revocable?

Mr. POOLE. Yes, sir. The condition of the license of a television broadcaster is that initial operations must be conducted for a limited number of hours per day for not less than 5 days per week.

From a practical point of view, that meant that in undertaking television operations we started off on a full-time basis, even though for those of us who pioneered at the time television operations were undertaken, there were virtually no receiving sets on the market.

In our own company our first station was at Toledo, Ohio, and there were roughly 150 receiving sets in Toledo when we first went on the air.

At the end of 6 months I would judge there were approximately 5,000 sets.

Senator MILLIKIN. What do you want us to do?

Mr. POOLE. There has been prepared, Senator, and introduced by Senator Frear, a bill, S. 1861, which we heartily support, and submit will adequately restore to the television industry a normal base-period experience.

It permits a taxpayer which has derived 30 percent or more of its income from broadcasting and related television services in the month of December 1950 to compute the average base-period net income by multiplying the taxpayer's total assets as of December 31, 1949, and those assets understandably would include the investment in television at that date, by the ratio of income to assets in 1946.

In other words, we throw ourselves back to the year 1946, taking 1 year out of the base period as being most nearly representative of the experience we would have had during the base period had we not gone into television.

In other words, that is as close as we can tie to anything definite that would illustrate or typify the experience that we would have had in radio broadcasting.

Senator TAFT. You do not try to separate the earnings from television and radio; you simply take the net results in 1946 where television did not have much effect.

Mr. POOLE. Exactly. It would be impossible from an administrative point of view, we feel, to try to separate it, and the impact was so slight that the industry will very happily absorb that if this relief can be given to it because its plight is so very critical.

Now, we relate that ratio forward to those assets in December 1949. That means, in effect, that we are asking to be permitted the same rate of return in television in terms of relationship to assets, as we had derived ourselves in 1946 from radio broadcasting.

Senator TAFT. Is that on an individual basis?

Mr. POOLE. It is on an individual basis, Senator, or in the alternative, it permits the taxpayer to use the industry rate of return for the single year of 1946.

Senator TAFT. As far as a new company that started solely in the television business, he would have to do that.

Mr. POOLE. Yes, sir. That is why it was included in the amendment. Otherwise there would be no basis for it.

Senator TAFT. Do you give one of these companies the alternative of taking the industry basis instead of his own?

Mr. POOLE. Yes; whichever is the greater.

Senator TAFT. Where he was in the radio business in 1946?

Mr. POOLE. Yes, sir; the industry average or the individual experience, whichever is greater.

Senator TAFT. What would the industry average be?

Mr. POOLE. As tentatively proclaimed by the Secretary, it is 24.9 for 1946.

Senator TAFT. Instead of the 15 that you now have?

Mr. POOLE. The 15.8 which would reflect our television loss experience.

There is an additional proposed amendment which would relate to new corporations organized after December 1, 1946, and which similarly gives and accords to them the industry average of 24.9 in 1946.

That is our story very simply. I should like to emphasize and make clear this point: These amendments in no sense create an exemption for the television broadcasting industry, nor is any suggestion of an exemption involved.

It is merely a matter of restoring us to a base-period experience so that we will pay excess-profits taxes on a parity with those industries which had a normal experience during those years, and to permit us the same equity under the act as those companies were intended to have under normal experience.

Senator BYRD. Thank you very much, Mr. Poole. Would you care to have the balance of your statement inserted into the record?

Mr. POOLE. Yes, sir.

(The prepared statement is as follows:)

STATEMENT ON BEHALF OF TELEVISION BROADCASTER'S TAX COMMITTEE

Mr. Chairman and gentlemen of the committee, my name is John B. Poole. I am a practicing lawyer in Detroit, Mich., and, more particularly, am an officer, director, and stockholder of the Fort Industry Co. The Fort Industry Co. is the owner and licensee of three television stations located at Detroit, Mich., Toledo, Ohio, and Atlanta, Ga. It is also the owner and licensee of seven standard radio stations located in the three cities named, and also at Wheeling, W. Va., Miami, Fla., Fairmont, W. Va., and Cincinnati, Ohio.

My appearance before the Senate Finance Committee is as a member of and spokesman for, the Television Broadcaster's Tax Committee, an industry-wide group organized by the National Association of Radio and Television Broadcasters and representative of the television-broadcasting industry. The committee serves a single purpose—that of petitioning the Congress to relieve the very serious and critical financial plight of the television broadcasters under application of the Excess Profits Tax Act of 1950.

Our industry problem is essentially this. In December 1945, the Federal Communications Commission first authorized commercial television broadcasting. Hence it was during the base period years 1946–49, that the radio-broadcasting industry undertook to develop and pioneer television. Losses sustained in television during this period so depressed normal profits derived from radio broadcasting that the average industry rate of return, as proclaimed by the Secretary, declined from 24.9 percent in 1946 to 10.1 percent in 1949. Moreover, these averages tell but a part of the story, because they also reflect the rate of return achieved by several hundred radio broadcasters not yet involved in television operations, and which hence had normal earnings. The rate of return for those companies actually engaged in television broadcasting declined so sharply from 1946 forward as to result in an over-all industry loss for the year 1949. To illustrate specifically, the following tabulation shows a breakdown of net taxable income earned from radio broadcasting and likewise, losses sustained in television, for each individual year during the base period, by those companies actually engaged in both radio and television broadcasting, exclusive of networks and network-owned stations. These figures, at the request of our committee, were made available by the Federal Communications Commission, and delivered to Haskins & Sells of New York City, for analysis. The analysis was made by Haskins & Sells to insure the privacy of individual financial information and to insure also an accurate and impartial analysis for presentation to the Senate Finance Committee.

	Number of companies	Amount
1946:		
Television	59	[1] $851,000
Radio	85	14,869,000
		14,018,000
1947:		
Television	66	[1] 2,015,000
Radio	85	15,284,000
		13,269,000
1948:		
Television	71	[1] 8,556,000
Radio	85	13,895,000
		5,339,000
1949:		
Television	85	[1] 13,520,000
Radio	85	12,353,000
		[1] 1,167,000
Average—1946–49:		
Television		[1] 6,236,000
Radio		14,100,000
Total		7,864,000

[1] Indicates loss.

These figures graphically illustrate the plight of the independently owned television-broadcasting stations throughout the country. Eighty-five corporate owners and licensees of television stations at the close of 1949 had collectively lost $24,708,000 in the operation of television, while earning $57,568,000 from radio broadcasting. Television losses in 1949 exceeded in dollar amount the entire aggregate of earnings from radio broadcasting and this trend continued late into 1950. While we do not have available the exact industry loss experience in 1950, we do know, as a matter of general industry information, that very few television stations turned the corner and began making a profit until the late fall of 1950.

Under the Excess Profits Tax Act, it is contemplated that the best 3 years in the 1946–49 period will fairly be representative of normal profit experience. As the tabulation shows, average industry income from radio broadcasting for the 1946–49 base period would have been $14,100,000 had not television operations been undertaken. Because of television losses, however, average base period income was $7,864,000, and it is upon the basis of the best 3-year average of this depressed period that the credit for the excess-profits tax is computed. To reconstruct normal base period years for the 85 companies involved in television broadcasting, this average base period income would need be restored from $7,864,000 to $14,100,000. In addition, some reasonable rate of return should be available as a credit for present and future earnings from television. According to figures supplied by the Federal Communications Commission, the radio broadcasting industry by the end of 1949 had invested approximately $56,000,000 in plant and equipment for television. Some reasonable return upon this investment should also be available as a credit before application of the excess-profits tax.

An excess profits tax credit, based on the invested capital method, however, does not answer our problem. A return upon capital of 12 percent, while adequate for manufacturing industries, is wholly inadequate for service industries, such as radio and television broadcasting where capital is but one of a number of equally important income-producing factors. The 1946 rate of return for radio broadcasting is 24.9 percent; the industry average, even after the impact of television losses, is 15.8 percent. Talent personnel and creative writing, for example, in radio and television broadcasting, are factors equally important with capital in terms of income production. Such services are very expensive, competition is very keen, the hazards are great, and the rate of return historically has necessarily been high in the radio and television field. During the 24 years of the Fort Industry Co.'s experience, more than 73 percent of company profits have been ploughed back into the operation of the company to permit expanding and improved program service and to keep pace with technological developments. Even so, it was necessary that the company borrow $1,500,000 to undertake construction of three television stations and as of June 1, 1950, our total investment and operating losses in television exceeded $2,000,000.

Nor, unhappily, do any of the relief provisions in the act relieve our plight. The average industry rate of return, 15.8 percent, which may be availed of if other qualifying factors are fulfilled, merely reflects the loss-experience the industry has sustained in television. As to new corporations organized after January 1, 1946, the same is equally true. This depressed rate of return is wholly inadequate to meet the competitive necessities in the television industry and to recoup past losses. Already the industry stands on the threshhold of further technological developments in the art with a consequent need and requirement for replacement of equipment, involving very substantial requirements for additional capital investment. Under present provisions of the act, the maximum tax ceiling automatically becomes the normal tax rate for every television broadcaster. We know of no other industry so unhappily circumstanced.

It should be mentioned that all radio and television broadcasting facilities must be licensed by the Federal Communications Commission, and all broadcasting and telecasting activities are subject to applicable regulations of the Commission. It is a condition of the license that television operations from the very inception must be carried on a minimum number of hours per day, for not less than 5 days per week. Translated into practical terms, this means that television broadcasters must commence operations on a full-time basis and, it being a mandate of the license that the telecaster operate in the public interest, convenience, and necessity, it means also that the program content at the very inception must be of the highest possible level. This is true notwithstanding that for most of us when television operations were undertaken, the number of receiving sets in the market was so small as to be nominal. For those of us who pioneered, the first year and one-half was a period of extreme anxiety, wondering whether our program presentations would so captivate the public that receiving sets would be purchased in increasing quantities. It was of course at all times obvious that, until reasonable circulation in the market was achieved, profitable operation was impossible for the station. This hazard is peculiar to radio and television, and stems in part directly from the obligation imposed by the license. We mention this to explain the incredible record of losses which the industry has sustained. Prudent business judgment does not counsel the pinoeering of a new business on so full blown a scale as to permit losses to exceed profits realized from the basic business, as was the experience in television during the 1949 year. The industry makes no complaint of this circumstance. It is a matter of serious concern, however, that the hazard should not be compounded in terms of an inadequate credit against the imposition of excess-profits taxes.

To relieve this inequity, Senator Frear of Delaware has introduced S. 1861 which has been referred to this committee. Essentially, it is proposed that section 444 of the act be amended by adding a new subsection (h) which will permit any taxpayer, which derived during the month of December 1950 30 percent or more of its gross income from television broadcasting and related television services, to compute its average base period net income by multiplying the taxpayer's total assets as of December 31, 1949, by (1) the ratio which the taxpayer's excess profits net income for its last taxable year, ending on or before December 31, 1946, bears to its total assets on the last day of such taxable year, or (2) the taxpayer's industry rate of return for the year 1946 as proclaimed by the Secretary under section 447, whichever is greater. This accomplishes two things. It permits the radio-television broadcaster to use the rate of return which it realized in 1946 as being representative of normal profit experience in radio operations. By substituting the 1946 year in lieu of the best 3 years in the 1946–49 period as a norm, the impact of television losses is thus essentially eliminated. Secondly, it permits the taxpayer to relate the 1946 ratio or rate of return to assets on hand at December 31, 1949 (which, of course, includes all assets then used in television). The resulting dollar figure after multiplication, is the telecaster's average base period net income under the act. The applicable percent of this figure, as finally determined, in the current bill, will be the excess profits tax credit. For those corporations which had no radio experience and have engaged exclusively in television operations, the proposed amendments permit use of the radio industry rate of return of 24.9 percent proclaimed by the Secretary for the 1946 year. In other words, the amendments serve to put the radio broadcaster back to his 1946 rate of return upon capital as being representative of his normal earning experience in radio during base period years. In addition, it permits him to relate this rate of return forward to television operations.

It is further proposed that section 445 be amended by adding a new subsection (i), in respect of new corporations organized after January 1, 1946, to permit use of the industry rate of return of 24.9 percent, proclaimed by the secretary for the 1946 year. We feel that these proposals are entirely reasonable and approximate as close as may be, the base period experience which would have been realized by the radio broadcsating industry, had it not undertaken television operations. In addtion, it relates this experience to the new television industry.

Because these proposed amendments involved technical problems relating to the structure of the act, and because they necessarily result in some initial loss of revenue to the Government, representatives of our committee consulted with Mr. Colin F. Stam, chief of staff of the Joint Committee on Internal Revenue Taxation, and with certain members of his staff. We wish to emphasize that these proposed amendments in no sense constitute an exemption for the television industry under the act. They serve merely to provide a reasonable and equitable basis for computation of an excess profits tax credit. According to our best estimates, the loss of revenue which will result to the Treasury in 1951 under these amendments will approximate $3,000,000, certainly no more than $5,000,000 as a maximum. Every telecaster will, of course, pay an excess profits tax under these amendments, but, and this is all we seek—on a basis of parity with other industries having a normal base period experience upon which to compute the excess profits tax credit.

From the technical point of view, we believe the amendments are wholly consistent with both the philosophy and structure of the act. They are designed, and in application achieve, no more than reasonable and necessary relief to our industry. We ask no more than this—but unless this relief is forthcoming, the impact of excess profits taxes upon the television industry and its further and future development will be critically grave indeed.

Senator BYRD. Mr. Paul Gardner.

STATEMENT OF PAUL GARDNER, PRESIDENT, DeWALT, INC.

Mr. GARDNER. Mr. Chairman, and members of the Senate Finance Committee, my name is Paul Gardner. I am president of DeWalt, Inc., of Lancaster, Pa.

DeWalt, Inc., manufactures a machine such as you see along the wall there, and it does all types of work similar to this.

This is a piece of lattice work out of solid wood. This machine does a great variety of work to aid builders in building houses, furniture factories in manufacturing furniture, and for industrial plants, in crating and boxing, carpenter maintenance, pattern shops and production work.

My company is a wholly owned subsidiary of American Machine & Foundry Co., and the relationship between DeWalt and American Machine & Foundry Co. was created in the following manner:

Prior to 1949 another corporation, also called DeWalt, which was entirely independent of American Machine & Foundry had carried on the business now carried on by the present DeWalt.

In November 1949 the old DeWalt sold its entire business, including all its assets, to American Machinery & Foundry for stock and cash.

The old DeWalt proceeded to liquidate, as required by agreement with American Machine & Foundry, distributing the proceeds of the sale to its stockholders.

American Machine & Foundry immediately transferred everything which it had received in this sale to the present DeWalt, which had just been organized for the specific purpose of continuing this business.

The present DeWalt is now carrying on the same business, with the same assets, and under the direction of the same officers, using the same labor and the same salesmen and dealers as those of the old DeWalt prior to the sale.

The only changes brought about by this sale were that the stock is now held by a new owner and a new corporate charter was substituted for the old.

I am appearing to propose an amendment to section 461 (a) (1). This section permits the so-called acquiring corporation to use the earnings credit of the selling corporation for excess profits tax purposes but only if the transaction was nontaxable.

The transaction in which the old DeWalt sold its business to American Machine & Foundry was a taxable transaction and the taxes have been paid.

Under the present law, our new corporation has a credit for excess tax purposes of only $200,000 where the credit of the old DeWalt would have been $850,000. In other words, merely because the property was transferred for cash and stock and not solely for stock and because the transaction was taxable, about $650,000 of its normal profits will be taxed under the excess-profits-tax rates.

Senator MILLIKIN. Is the business the same?

Mr. GARDNER. The same identical business, the same facilities, the same product.

Senator MILLIKIN. No new activity?

Mr. GARDNER. I have been the president of it now continuously, for almost 25 years, both the old company and this company.

Senator MILLIKIN. Make the same product?

Mr. GARDNER. Same identical product. The product is right here.

Senator KERR. Where are your headquarters located?

Mr. GARDNER. My headquarters are Lancaster, Pa.

Senator MILLIKIN. The committee is familiar with that problem.

Mr. GARDNER. I see.

Well, in this case, as I understand it, the trend of the law from the House move to date, is to reduce the credit from 85 to 75 percent of normal earnings. In effect, if an amendment is not passed that will give new DeWalt the earnings base of old DeWalt, our credit will be reduced from 85 percent to less than 25 percent and it is a pretty discouraging thing to work out when you are trying to help stockholders who can only get half the price that they paid for their stock to get their money back.

Senator MILLIKIN. You want it carried forward to the base, and you want relief against the reduction proposed by the House?

Mr. GARDNER. I am especially interested in carrying forward the base period earnings I am willing to pay the rates that you gentlemen decide are appropriate for everybody, but I feel that I am going to have to pay more than those rates if no relief is given.

Senator MILLIKIN. I was going to ask if the gentleman has entered his full statement.

Mr. GARDNER. I am sorry; I do not have a statement to enter.

Senator MILLIKIN. The committee is familiar with the problem It has been raised by several other witnesses.

Mr. GARDNER. I see.

Senator KERR. What is the present law, Mr. Stam?

Mr. STAM. Well, I think you pointed out that under the present law you have to go through a nontaxable transaction.

Senator KERR. I could not tell whether his situation was one which was all right as the law now is, and would be put in jeopardy by the amendment, or whether it is not now all right, and needs an amendment, but a different one from that which the House put on.

Mr. STAM. Well, it is not all right under the present law.

Senator KERR. Yes.

Mr. STAM. He wants relief from it.

Senator KERR. And he would not be helped under the amendment?

Mr. STAM. He would not be helped under the amendment.

Senator KERR. In other words, it is a situation where the amendment prepared by the House would provide relief for others in identical positions with him except that theirs was a nontaxable transaction, and his is a taxable transaction.

Mr. STAM. Well, it really was not the House. The existing law provides relief only where there is a nontaxable transaction.

Senator KERR. I see.

Mr. STAM. And he is trying to get that changed.

Senator KERR. I thought he said there was an amendment coming over from the House putting him in jeopardy or failing to give him relief.

Mr. STAM. Well, it hits him a little harder when they reduce that 85 down to 75.

Senator KERR. I see.

Mr. GARDNER. I feel that the difference, to make it as clear as possible, is that we have had two corporations here; they are both identical. The only change—the business is identical—is the change in stockholders. That is all.

But because the change in stockholders was made with some stock and some cash instead of just stock, because of that technicality, we would, as I understand it, unless an amendment is made, lose the base-period earnings of the company that I have been head of now for some 25 years.

Senator MILLIKIN. Thank you very much, Mr. Gardner.

Senator MILLIKIN. The next witness is Mr. George E. Gregory.

Will you come forward, please, and give your name to the reporter.

STATEMENT OF GEORGE E. GREGORY, PRESIDENT, MORTON GREGORY CORP., LORAIN, OHIO

Mr. GREGORY. Mr. Chairman and members of the Senate Finance Committee, I am George E. Gregory. I am president of the Morton Gregory Corp. of Lorain, Ohio.

Senator KERR. Would you rather be seated, Mr. Gregory?

Mr. GREGORY. Yes, sir. Thank you.

May I first express my thanks for this opportunity to appear before you.

I want to discuss certain effects of the excess-profits-tax law of 1950 upon new, small and growing businesses and to make simple recommendations to correct, serious, yet unintentional inequities.

My company was organized in early 1948 with a capitalization of $556,250, all of which came from employees and close friends. Employment then was 110; now we employ 257 persons. You can see that we are, by definition, a small business.

But we are an aggressive small business. We are determined to grow and to prosper by our own efforts and ingenuity. Our principal business is the manufacture and sale of Nelson stud welding guns and studs. Nelson stud welding was a war-born process involving the split-second joining of a metal stud to a metal plate by means of arc welding. A tremendous amount of engineering and sales effort has been required to create peacetime markets for our products, in the face of established competitive methods.

Like many other small businesses, however, we are not afraid of competition, big or little, established or new. Nor are we afraid of adapting our operations to Government regulation and taxation necessary for defense—so long as these controls and taxes are equitable.

We submit that the present excess-profits-tax law is not equitable to many small businesses. This act requires that they—and we pay an excess-profits tax on earnings that are not excess but are, in reality, normal profits.

We discussed this problem with independent tax consultants and economists. We became convinced that many small businesses so important to the backbone of America—could be stifled by a tax burden, over and above that intended by Congress.

Convinced of this, we sought and, I believe, found two solutions—solutions that would remove inequities not only for ourselves but also for many other businesses. In other words, our proposals are not geared for one isolated hardship case. Nor are they intended to give small businesses a special privilege. Rather they would protect small enterprises from special injury by the very Government that spends millions to aid and encourage them.

The technical language and operation of these proposals are set forth in the brief which is attached to your copy of my statement.

I said that the present tax law requires us to pay excess-profits taxes on earnings that are in reality normal. Relief provisions of the act were designed to prevent normal earnings from being considered excess profits. These provisions allow a credit based on a "fair rate of return" on the "adjusted basis of assets."

However, a careful analysis shows that these provisions do not correct obvious inequities in situations such as ours. I should like to discuss the way both the "fair rate of return" and the "adjusted basis of assets" provisions fail to correct the inequities for many small businesses.

I must, of course, talk of my own company as an illustration, since it is the one with which I am most familiar. But I am sure that you will see how the same circumstances apply to numerous small concerns, probably some you know of yourselves.

On the matter of "fair rate of return." There is that situation in which a specialized small business is lumped with a group of mass output companies for the calculation of this "fair rate of return" on its assets. The act provides that earnings of our company be based on those of industries classified as groups 33 and 34 in the Standard Industrial Classification Manual. These groups are primary and fabricated metal producers. They comprise a heterogeneous array of companies with which ours has little in common—blast furnaces, foundries, rolling mills, safes and vaults, and plumbing fixtures. They produce standardized goods and, because of that, create little value in the process of manufacture.

Our business is a highly specialized field. We create a high value in manufacture because our products are individually tailored and engineered for each customer's application. Our products are not shelf goods and cannot be bought from catalogs. Each sale must be preceded by most detailed technical studies and analyses of the customer's problem. Our products are then engineered into specific uses.

This obviously results in a high value, added by manufacture. Authoritative studies show that the greater the value added by manufacture, the greater the margin of profit. We cite references to those proofs in our study made available to the staff of the Joint Committee on Internal Revenue Taxation.

From these studies, one basic conclusion can be drawn:

The fair rate of return permitted under EPT should be adjusted to provide for wide variances in the value added by the manufacturer.

How would this affect small business? As a rule, it is the small manufacturer who uses special skills, gives extra attention to details, makes specific designs for individual needs to sell his product, rather than utilizing a high degree of mechanization, uniformity, and large-scale operations of large enterprises. With this "tailored fitting" they can compete not only among themselves but with manufacturers operating on a larger but more impersonal scale.

These special techniques mean a relatively high "value added" for the output of small concerns. And society has shown its willingness to pay a fair price for the added contribution. It's as simple as the extra price you may pay for having a suit tailored to your individual measurements rather than buying one mass-produced on "dummy" models.

In justice, therefore, this unique contribution of small business should be recognized in determining for them a fair and reasonable rate of return on assets.

Senator MILLIKIN. Would you apply the same rule to tailors?

Mr. GREGORY. Well, I suppose you could; yes, sir.

Let me give you an example, Senator: The Treasury Department has ruled that 13.8 percent is a fair rate of return for companies in groups 33 and 34 with which our company is lumped. But the "value added" ratio of these groups is only 46.2 percent, while the comparable figure for our own company is 77.5 percent. Our studies show many other companies are in the same fix.

It is manifestly unfair and unjust to include our company and other small specialty businesses in with a motley array of standardized, mature industries which create relatively so much less value than we do.

This group 33 and 34 is a group of 10 percent of the industry in America.

As I have pointed out, the earnings rate should be proportionate to the value added by manufacture, but under present law, obviously we, and others like us, will find our allowable rate of return "cut down" to the rate of the standardized producer who adds considerably less value to his product. We will have earnings that should be "normal" taxed as "excess profits."

A suggested amendment providing an equitable adjustment of rate of return is included in our brief. It has the added advantage of simplicity in computation and administration.

Now I will turn to the problem of "adjusted basis of assets." Although this may not have quite the broad application of the first point, a glaring inequity does exist.

The act provides that normal earnings should be measured by a fair rate of return on the adjusted basis of our assets. And there, gentlemen, is the "catch." Our company's most valuable assets—our patents—have no book value.

Let me explain why. Morton Gregory Corp. was formed in 1948 and purchased the assets of the Nelson Stud Welding Business. As part of the purchase agreement, payment for patents, applications, trade-marks, and inventions is spread over 12 years. Payment is 2½ percent of the business done with a minimum annual payment of $25,000. At the time, this appeared eminently fair to seller and to buyer. But, as a result, these valuable assets—now being used to create earnings—taxable earnings, if you please—have no valuation when computing our "adjusted basis of assets."

Over the life of this agreement we expect to pay more than $2 million. If we had paid that amount in a lump sum——

Senator KERR. For those assets.

Mr. GREGORY. That is right, sir.

Senator KERR. Under which law you cannot give any value to in setting up your base if you use this adjusted basis of assets.

Mr. GREGORY. That is what I am talking about, Senator, yes.

If we had paid that amount in a lump sum, rather than on this deferred basis—and the deferred basis was the only thing I could afford at that time—these assets would be admitted in the computations required for tax purposes. You can easily see that unless the law is amended to permit a fair valuation of these assets, our company, and others with similar arrangements, will suffer from the accidental nature of a negotiation.

Senator KERR. In other words, if you do not seek specifically a provision that would let you use their estimated fair value but one which would permit you to use an accurate estimate of what they would actually cost you——

Mr. GREGORY. That is right, Senator, and we are proposing an amendment as part of this brief——

Senator KERR. Yes.

Mr. GREGORY. That will take care of that.

Now, as I say, we have a small company and we plan a rapid growth in the next 2 or 3 years. Like the other men have said, this expansion requires capital. Elimination of the two inequities which I have discussed will remove the unnecessary and unintentional limitations on our ability to secure capital and credit.

We do not seek special benefits. We seek only to see small business relieved of special injury.

Thank you for permitting me to appear before you.

I will present this for the record.

Senator MILLIKIN. The entire document will be made part of the record.

(The document referred to follows:)

INEQUITY OF EXCESS PROFITS TAX ACT OF 1950 ON NEW SMALL GROWING BUSINESS

(Submitted by Morton Gregory Corp., Lorain, Ohio)

SUMMARY

1. Morton Gregory Corp., formed in 1948 and employing 257 people, manufactures stud welding equipment.

2. The stud welding process was acquired from the patentee on terms which included 2½ percent of the gross income received for 12 years as the payment for patents, patent applications, trade-marks and inventions. This type of purchase agreement was completely overlooked in wording the 1950 statute.

3. The relief provisions of the Excess Profits Tax Act of 1950 are of no real benefit to this company.

4. The company's most valuable asset (its patents), for which it has paid and will pay substantial amounts, does not have an "adjusted basis," as defined by the Internal Revenue Code.

5. In determining the rate of return, the Bureau of Internal Revenue classifies the company with a motley array of unrelated industries whose value added by manufacture is 46.2 percent of the value shipped.

6. The stud-welding business, being of a highly specialized nature, requires great emphasis on technical assistance and engineering service to customers, and its value added by manufacture is consequently 77.5 percent.

7. A company with a high value added percentage tends to create more value in the process of manufacture than a company with a lower ratio and for that reason is entitled to a higher rate of return.

8. Under the present act and its so-called relief provisions, Morton Gregory Corp. will be required to pay excess profits taxes at the maximum rate on earnings which are in reality normal.

9. Unless relief can be given, the future growth of this small company is extremely doubtful because of the financing problem created by the Excess Profits Tax Act.

10. Amendments are suggested which will equitably face the realities of this problem and which will afford some relief from this extremely serious tax burden.

HISTORY

Morton Gregory Corp. was incorporated in January of 1948. Its principal business is the manufacture and sale of stud-welding guns, control mechanisms, parts and studs. Stud welding is a war-born process developed in 1940 whereby a metal stud is joined to a metal plate by means of arc welding. The gun holds the stud in place and, together with the control mechanism, determines the time and pressure necessary for a correct arc weld. The process being relatively new required a tremendous amount of engineering and sales effort to develop markets for the product.

Morton Gregory Corp. acquired its stud-welding business in 1948 from the patentee, Ted Nelson, for $484,100, plus 2¼ percent of the gross income received from the business for 12 years with a minimum annual guarantee of $25,000. The $484,100 covered inventories, plant, and equipment, while the 2¼ percent of the gross income covered patents, patent applications, trade-marks and inventions.

The development of markets and the creation of demand required a complete revitalization and reorganization of the company's commercial development program, the setting up of market research and sales programs, and particularly the institution of a program of engineering and development work, whereby the utility and economy of the Nelson stud-welding process could be demonstrated and sold to prospective customers. It should be emphasized that in meeting the competition in peacetime markets stud-welding equipment has not sold itself. Markets for the company's products have been created only by the most extensive sales efforts on the part of the company. The Nelson business is of a specialty type requiring a high, fixed overhead resulting from the large technical and engineering staff which must be employed in order to carry on the engineering service essential to selling. This engineering service means the task of educating potential users in what the Nelson process is and what it can do; the analysis of mechanical applications; the complete design and engineering of the end product and its methods of manufacture; the preparation of cost estimates; and the indoctrination in operating know-how.

The task of organizing and training to provide this engineering service, of market research to determine in what industries the potential market lay, of distribution analysis to find out through what channels potential customers bought, and of finding out how best to promote sales to these markets was time consuming and costly. In view of the fact that the stud-welding process was still new and unproven in peacetime there were no precedents upon which to judge the correctness of decisions made. As a consequence, for the 2 years from the spring of 1948 to the spring of 1950, the policies determined, methods employed and decisions rendered had to be to a large extent based on trial and error, cut and fit. The results began to show up in sales figures in the late spring of 1950. The 3 months of May, June, and July 1950 showed a sales gain of over 15 percent over the comparable months of 1949. These figures are pre-Korea, since the manufacturing cycle was at that time 4 to 6 weeks and July shipments would reflect pre-Korea orders.

Sales for the 4 months of January through April 1951, showed an increase of 84.6 percent over the corresponding period of 1950. This compares with an increase of 28.6 percent over the same period in the Federal Reserve Board Index of Durable Manufactures. In other words the company's growth was three times what might be expected to result from improved business conditions or from the defense effort. This increase in the company's sales over and above what may be expected as a result of the Korean War is actually the result of engineering Nelson stud welding into the products of industry and the 2 years of planning, organization, and sales development work which culminated in this result. That this is true is evidenced by the fact that as late as April 1951, only 23 percent of all orders received were defense rated. Shipments were, of course, considerably under this percentage figure.

EFFECT OF PRESENT TAX LAW, INCLUDING RELIEF PROVISIONS

Under the Excess Profits Tax Act of 1950 Morton Gregory Corp. will be required to pay taxes at the maximum rate prescribed under the act on profits which are substantially normal in that these earnings were anticipated as peacetime results from the commercial development program pursued by the company in the years 1948, 1949, and 1950.

The act attempts to provide for relief in cases such as this by allowing the taxpayer to use as a credit an amount based upon what is supposed to be a fair return on the "adjusted basis" of its assets as of the first day of its first excess-profits-tax year. The inequity of any such method of providing relief in the case of Morton Gregory Corp., however, is due to two very salient facts, namely:

1. Its most valuable asset (its patents), for which it has paid and will pay very substantial amounts, does not have an "adjusted basis," as defined by the Internal Revenue Code, which reflects the entire amount which has been paid and will be paid for these patents, and

2. The fair rate of return on its assets, as provided by the existing statute, is not in anywise indicative of a reasonable rate of return for a corporation in a business such as that engaged in by Morton Gregory Corp.

RECOMMENDED REMEDY WITH RESPECT TO "ADJUSTED BASIS" OF ASSETS

As has been previously stated when Morton Gregory Corp. purchased the assets of the business, payment for the patents, etc., was to be made over a period of 12 years at the rate of 2½ percent of the gross business done. Hence, this most valuable asset has no "adjusted basis" as that term is defined by the Internal Revenue Code. Based on actual business experiences since the commencement of business, it is now possible to place a fair valuation on these valuable assets, which have no "adjusted basis" under the code.

Therefore, the following proposed amendment to section 442 (f) of the Excess Profits Tax Act of 1950 is respectfully submitted.

"'Effective with respect to taxable years ending June 30, 1950, section 442 (f) of the Internal Revenue Code is hereby amended by adding thereto the following: "*Provided, however*, that if upon the date as to which the computation is made the taxpayer is the owner of as asset or assets (other than inadmissible assets) and the amount of the payment therefor or cost thereof, or any part, hereof, is contingent upon an event or events to take place after said date, then the adjusted basis of such property shall include an amount equal to the present value on said date of the anticipated payments, or the said asset or assets shall be taken into account at their fair market value, whichever is the high amount.'"

RECOMMENDED REMEDY WITH RESPECT TO INDUSTRY RATE OF RETURN

In determining the rate of return to be applied to the asset base, the Bureau of Internal Revenue is basing its determination upon the earnings of manufacturing companies classified in groups 33 and 34 of the Standard Industrial Manual. Group 33, primary metal products, and group 34, fabricated metal products, together comprise no less than 48 different industries making up 11.25 percent of the value added by all manufacturing in the United States. In other words, Morton Gregory Corp. is being compared with a segment of the manufacturing economy that is more than one-tenth of the total, compared with a motley array of industries that have no relation or a very remote relationship to the business of the company. It is submitted that use of such a comprehensive grouping of industries for rate of earnings determination is unfair and unrealistic, although under the present law it can be done.

The 1947 Census of Manufactures prepared by the Department of Commerce compiles the value added by manufacture for each standard industrial classification. The census defines the term as follows:

"Value added by manufacture is calculated by subtracting the cost of materials, supplies, containers, fuel, purchased electric energy, and contract work from the total value of shipments."

The census goes on to describe the significance of value added by manufacture as follows:

"In that it approximates the value created in the process of manufacture, value added provides the most satisfactory measure of the relative economic importance of given industries available in the census of manufacture."

It follows from the above statement by the Bureau of the Census, Department of Commerce, that an industry which has a high ratio of value added to value of shipments creates more value in the process of manufacture. Such an industry would be expected to earn more per dollar of sales or per dollar of assets than an industry with a low ratio of value added. The same reasoning applies to an individual company, for a company with a high value added ratio tends to create more value in the process of manufacture than a company with a lower ratio and for that reason is entitled to a higher rate of return.

In the case of group 33, primary metal products and group 34, fabricated metal products, the two groups used by the Bureau of Internal Revenue in computing the rate of return applicable to Morton Gregory Corp., the value added as a percentage of the value shipped is 40.2 percent.

In earlier paragraphs the highly specialized nature of the Nelson stud welding business was developed in some detail. It was pointed out that in the creation of markets where none had previously existed the company relied upon a technical and engineering approach. The result of this approach has been the creation of high value in the process of manufacture. In the fiscal year ended April 30, 1951, the ratio of value added by manufacture to value shipped was 77.5 percent.

It is submitted that to group Morton Gregory Corp. with its value added ratio of 77.5 percent with a heterogeneous grouping of the metal industries whose value added ratio is 40.2 percent is manifestly inappropriate and unjust. If the rate of return is related to value received, an assumption axiomatic in a competitive economy, certainly the base upon which the rate of return is computed should be adjusted to compensate for the higher value.

Therefore, the company respectfully submits the following amendment to section 447 (b) of the Excess Profits Tax Act of 1950:

"Effective with respect to taxable years ending after June 30, 1950, section 447 (b) of the Internal Revenue Code is hereby amended by adding thereto the following: 'Where the rate of the value added by manufacture (as defined in Statistics by Industry: Census of Manufactures: 1947, vol. II, p. 18) in the case of any taxpayer for its first taxable year under this title exceeds the average of the rate of such value added by manufacture of its industry classification as reflected by the 1947 Census of Manufactures by more than 10 percent, then the industry base period rate of return applicable to such taxpayer shall be increased in the same ratio as the said rate of value added by manufacture of such taxpayer for its first taxable year under this title bears to the said average of the rate of such value added by manufacture of such industry classification for 1947'."

Relevance of Value Added by Manufacture as a Measure of Value Created and Contribution to Society and as an Index of a Justifiable Rate of Return on Assets

(By Theodore N. Beckman, B. Sc., M. A., Ph. D., professor of business organization, The Ohio State University and consulting economist)

The concept of value added by manufacture has long been accepted by economists and statisticians as fundamentally valid and useful in the conduct of research in the social sciences. It is given concrete expression by the Bureau of the Census of the United States Department of Commerce by the following definition:

"Value added by manufacture is calculated by subtracting the cost of materials, supplies, and containers, fuel, purchased electric energy, and contract work from the total value of shipments." [1]

IMPORTANCE AS A MEASURE OF VALUE CREATED

That value added by manufacture is a significant measure of value created and hence of the economic contribution made to society can be gleaned from the following statement on this score made by the Bureau of the Census:

"In that it approximates the value created in the process of manufacture, *value added provides the most satisfactory measure of the relative importance of given industries* available in the Census of Manufactures." [2] [Emphasis supplied.]

[1] Census of Manufactures: 1947, vol. II, Statistics by Industry, U. S. Government Printing Office: Washington, 1949, p. 18.
[2] Ibid.

IMPORTANCE IN GAGING RATE OF RETURN

It follows, therefore, that an industry that has a high value added ratio (percentage of the value added to value of shipments or net sales) creates more value in the process of manufacture than one with a lower ratio. Such an industry would, therefore, be expected to earn more per dollar of sales, or in terms of any other base as per dollar of assets employed, than an industry with a lower value added ratio, so long as it is assumed that the rate of return is, in a fairly competitive economy, related to value received, which is almost axiomatic. The same reasoning applies to an individual company. A company with a high value added ratio, unless it is extremely inefficient and lack of competition makes such inefficiency possible, tends to create more value in the process of manufacture than a company with a lower ratio and, for that reason, should be entitled to a higher rate of return.

Expressions to that effect may be found in writings arising out of work in connection with the renegotiation law in effect during World War II, as can be seen from the following quotation taken from a most comprehensive study by a man with considerable experience with such work:

"Let us examine another group of factors considered in determining the profit rate to be allowed, namely, (1) complexity of production technique, (2) degree of integration, and (3) *value added by contractor.*" * * *

"A firm which mainly assembled and marketed components or materials purchased outside or furnished by the Government would normally receive a lower profit rate than one which *added more value through its own operations. This was one of the first factors considered in evolving an allowable profit rate.*" [3] [Emphasis supplied.]

In commenting on a given point in the Renegotiation Act of 1951, section 103, dealing with definitions, a leading service contains the following statement:

"The character of the contractor's business is an important consideration in the determination of excess profits, since manufacturing contributions varies with the nature of the product and the degree of skill and precision required by the work. The greater the manufacturing contribution of the contractor, the greater should be the margin of profit. A greater part of the ultimate value of the product is contributed by a contractor who performs a large proportion of the work directly than by one who merely assembles the product." * * * [4]

PROOF OF VALIDITY OF THE VALUE ADDED THEORY IN RELATION TO RATE OF RETURN

In order to test the validity of the basic theory that value added is a satisfactory measure of value created in the process of manufacture and the logical assumption that a higher rate of return should therefore accompany a higher value added ratio, pertinent data were collected with respect to certain industry classifications that are relevant to the specific company involved in the matter. In table 1 are presented the value of products shipped and the value added by manufacture for each of the 48 industries comprising the Standard Industrial Classification Major Industry Groups 33 and 34. As shown under Sources, the data for the table were obtained for the year 1947 from the census of manufactures and that is the only year of the base period 1946-49 for which such data are available.

It will be noted from the date in table 1 that the value added by manufacture for the year 1947 by all 48 industries making up major groups 33 and 34 was 46.18 percent and that these industries made up 11.25 percent of all manufacturing in the United States in terms of value added. According to the tentative rates of return promulgated by the Treasury Department for purposes of application under the excess-profits-tax law, the rate of return on assets for these groups for the same year (1947)was 15.4 percent.

[3] Thomas B. Worsley, Wartime Economic Stabilization and the Efficiency of Government Procurement published by the National Security Resources Board, U. S. Government Printing Office: Washington, 1949, p. 281

[4] Commerce Clearing House, Inc., in Government Contracts Reporter (30,177).

TABLE 1.—*Value of products shipped and value added by manufacture, United States, 1947—Major Groups 33 and 34 (except ordnance, machinery, and transportation equipment)*

[In thousands of dollars]

Census of manufactures industry classification	Value of products shipped	Value added by manufacture
Major Group 33—Primary metal products:		
Blast furnaces	$1,713,945	$328,060
Electrometallurgical products	150,904	55,493
Steel foundries	413,094	267,214
Gray-iron foundries	1,172,671	732,647
Malleable-iron foundries	184,400	121,661
Primary zinc	190,996	77,068
Primary aluminum	161,010	65,262
Secondary nonferrous metals	724,027	119,667
Copper rolling and drawing	1,063,658	302,502
Aluminum rolling and drawing	404,766	150,697
Nonferrous metal rolling [1]	193,090	50,074
Nonferrous foundries	562,137	295,834
Iron and steel forgings	370,097	197,111
Wire drawing	912,095	314,788
Welded and heavy riveted pipe	218,875	89,614
Primary metal industries [1]	339,663	138,642
Total	8,775,428	3,306,424
Value added, percent of value shipped		37.68
Major Group 34—Fabricated metal products:		
Tin cans and other tinware	$679,860	$231,953
Cutlery	142,571	104,833
Edge tools	62,438	40,472
Tools for cutlery and edge tools	205,009	145,305
Hand tools [1]	272,543	174,540
Files	24,493	19,149
Hand saws and hand blades	70,430	42,975
Hardward [1]	578,269	346,457
Metal plumbing fixtures and fittings	291,907	155,944
Oil burners	106,781	44,388
Heating and cooking apparatus [1]	1,134,085	589,192
Structural and ornamental products	864,435	440,701
Metal doors, sash and trim	206,088	117,642
Boiler-shop products	704,547	358,764
Sheet-metal work	424,305	226,446
Vitreous-enameled products	74,382	45,116
Metal stampings	1,164,299	642,483
Enameling and lacquering	23,868	16,638
Galvanizing	27,111	15,296
Engraving on metal	20,543	16,252
Plating and polishing	176,492	125,388
Lighting fixtures	474,759	247,619
Nails and spikes	30,038	15,721
Wirework,[1]	464,625	266,426
Metal barrels, drums, and pails	173,060	64,119
Safes and vaults	29,216	19,434
Steel springs	92,646	45,876
Bolts, nuts, washers, and rivets	463,752	285,451
Screw-machine products	220,542	143,853
Collapsible tubes	26,997	16,942
Metal foil	54,638	21,439
Fabricated metal products [1]	73,205	39,967
Total, Group 34	9,357,934	5,066,781
Value added, percent of value shipped		54.14
Total Major Groups 33 and 34	$18,133,362	$8,373,205
Value added, percent of value shipped		46.18

[1] Not elsewhere classified.

Source: Census of Manufactures: 1947, volume II, Statistics by Industry, U. S. Government Printing Office, Washington: 1949, pages 529-635.

Since the value of products shipped is not given by the census for industry groups but only by individual industry classifications, it was necessary to prepare this tabulation in order to obtain a total for the industries covered under Groups 33 and 34 in appendix A (tentative rates of return) by the Bureau of Internal Revenue.

As the total value added by all manufacturing establishments in the United States in 1947 was $74,425,825,000, the industries covered in this tabulation represented 11.25 percent of all manufacturing in terms of value added ($8,373,205,000 divided by $74,425,825,000).

An attempt was then made to secure data on the screw machine products industry (Standard Industrial Classification 3495) of which the interested company is a member, but such data are not available on rates of return on assets. By personal contact, through a representative, with the Statistical Division of the Bureau of Internal Revenue in Washington and with the cooperation of its personnel it was possible to obtain the necessary data for a subdivision of Major Groups 33 ane 34, known as Industry Classification 349, in which belongs the screw machind products industry (3495). As the Bureau of Internal Revenue classification is somewhat different from that included in the Standard Industrial Classification Manual under the same number designation, the detailed composition of this industry classification as used by the Bureau of Internal Revenue is presented in table 2. By following closely this detailed composition of Industry 349 it was possible to compile data on value of shipments and value added, respectively, from the Census of Manufactures for the year 1947 for the identical parts of this industry classification. The results are presented in table 3, which show that the value added for Industry 349 was 54.15 percent compared with 46.18 percent for major groups 33 and 34, or 17.26 percent higher. If the comparison is made with the value added of Major Groups 33 and 34 exclusive of the industries covered by 349, which amounted to 41.66 percent, then the value added by Industry 349 was 29.98 percent higher (54.15 divided by 41.66, less 100).

TABLE 2.—*Excerpts from instructions for coding industrial activity, Statistical Division, Department of Internal Revenue—Major Groups 33 and 34—Iron, steel, and products*

349—OTHER IRON AND STEEL PRODUCTS (NOT FALLING WITHIN THE SUCCEEDING MAJOR GROUPS) INCLUDING METAL STAMPING, FOUNDRY, AND WIRE PRODUCTS

- Iron and steel foundry products:
  - Gray-iron and semisteel castings
  - Malleable-iron castings
  - Steel castings
  - Cast-iron pipe and fittings
- Wire products (made from purchased wire):
  - Wire drawing (from iron, steel, or nonferrous rods)
  - Nails and spikes
  - Wirework not elsewhere classified:
    - Animals traps
    - Barbed wire
    - Baskets and trays
    - Cable and wire, not insulated
    - Cages
    - Concrete-reinforcing wire
    - Fencing wire
    - Kitchen wire goods
    - Springs, wire (except complete bed springs)
    - Tire chains
    - Welding wire
    - Wire cloth and netting
- Metal stamping and coating:
  - Vitreous-enameled products:
    - Kitchen, household, and hospital utensils
    - Refrigerator, stove, and washing-machine parts
    - Table tops
  - Automobile stampings
  - Stamped and pressed metal products:
    - Bottle and jar crowns and screw caps (metal)
    - Bottle caps and tops (metal)
    - Cans, ash and garbage
    - Pails and pans
    - Perforated metal
    - Metal stamping and spinning combined (ferrous) for the trade
  - Enameling, japanning, and lacquering of metal products
  - Galvanizing and other coating:
    - Coating with aluminum, lead, zinc, etc.
    - Retinning cans and utensils
    - Rust-proofing on metals

Miscellaneous iron and steel products:
- Bolts, nuts, washers, and rivets:
  - Lock washers, plain washers
  - Turnbuckles and toggle bolts
- Iron and steel forgings (not made in rolling mills):
  - Anchors
  - Anvils
  - Axles
  - Car wheels
  - Chains (except bicycle and motorcycle drive chains)
  - Drop forgings
  - Forged parts for automotive equipment, machinery, and railway equipment
  - Frogs
  - Railway switches (forged)
- Wrought pipes, welded and heavy riveted: conduit, wrought welded
- Steel springs:
  - Coiled flat springs
  - Leaf springs
- Screw-machine products and wood screws: Screws (ferrous and nonferrous): Cap, set, wood
- Steel barrels, kegs, and drums: Cans (except tin cans) made of stamped and pressed metals
- Safes and vaults:
  - Safe-deposit boxes and chests
  - Locks (except time locks): Safe, vault
  - Vault doors and linings
- Iron and steel products, not elsewhere classified:
  - Boxes, metal (other than tin)
  - Cold-rolled strip and sheets
  - Annealing, heat treating, tempering, and hardening of steel for the trade

TABLE 3.—*Value of products shipped and value added by manufacture—United States: 1947—Bureau of Internal Revenue Industry Classification 349*

[In thousands of dollars]

Census of manufactures industry classification	Value of products shipped	Value added to manufacture
Steel foundries	$413,094	$267,214
Gray-iron foundries	1,172,671	732,647
Malleable iron foundries	184,400	121,661
Wire drawing	912,095	314,788
Nails and spikes	30,038	15,721
Wirework [1]	464,625	266,426
Vitreous-enameled products	74,382	45,116
Metal stampings	1,164,299	642,483
Enameling and lacquering	23,868	16,638
Galvanizing	27,111	15,296
Plating and polishing	176,492	125,388
Bolts, nuts, washers, and rivets	463,752	285,451
Iron and steel forgings (not made in rolling mills)	370,097	197,111
Welded and heavy riveted pipe	218,875	89,614
Steel springs	92,646	45,878
Screw machine products	220,542	143,853
Metal barrels, drums, and pails	173,060	64,119
Safes and vaults	29,216	19,434
Primary metal products [1]	339,663	138,642
Total	6,550,926	3,547,478
Value added, percent of value shipped		54.15
Value added, Industry 349 to value added, major groups 33 and 34: 54.15 ÷ 46.18 percent		117.26
Value added, Industry 349 to value added, major groups 33 and 34, exclusive of Industry 349: 54.15 ÷ 41.66 percent		129.98

[1] Not elsewhere classified.

Source: Basic data taken from Census of Manufactures: 1947, volume II, Statistics by Industry, U. S. Government Printing Office, Washington: 1949. Specific classifications chosen from the Census of Manufactures to correspond to subdivisions used by Bureau of Internal Revenue for its Industry Classification 349.

In line with the theory about value added and the assumption that a higher rate of return should accompany a higher value added ratio, it stands to reason that the rate of return in Industry 349 should be higher than for Major Groups 33 and 34. That such was actually the case is indicated by the data shown in table 4. From these data it will be noted that the sum of the aggregate net income before taxes and the aggregate interest deductions in 1947 amounted to $555,277,000 and the total assets at the end of the year aggregated $2,747,891,000, making a return on net assets of 20.21 percent ($555,277,000 divided by $2,747,891,000), compared with a net return for Major Groups 33 and 34 for the same year of only 15.4 percent. Thus the return on assets for Industry 349 was 31.21 percent higher than for Major Groups 33 and 34 (20.21 percent divided by 15.4 percent, less 100).

TABLE 4.—*Pertinent data bearing on rate of return on assets of industry classification 349 for the years 1946 and 1947*

	All returns		Returns with balance sheets	
	With net income	With no net income	With net income	With no net income
	1946			
Number of returns	2,848	1,100	2,787	1,021
Total assets [1]	1,960,185	424,020	1,960,185	424,020
Interest paid	5,647	2,544	5,534	2,482
Net income before taxes	357,755	[2](43,957)	354,459	[2](42,654)
Gross sales	3,042,499	475,285	3,015,728	467,000
Gross receipts from operation	19,804	4,035	19,708	3,805
	1947			
Number of returns	3,230	1,263	3,154	1,167
Total assets	2,615,567	132,324	2,615,567	132,324
Interest paid	9,140	1,509	9,073	1,464
Net income before taxes	562,466	[2](17,838)	557,966	[2](16,684)
Gross sales	4,524,720	197,108	4,491,414	191,907
Gross receipts from operation	25,479	3,809	24,961	3,643

[1] All figures except those which show number of returns are rounded to the thousands.
[2] Figures in parentheses connote a deficit.

Source: From the Washington Records of the Bureau of Internal Revenue.

There is every reason to believe that the rate of return was still higher for industry 3495 (screw machine products), which had in 1947 a value added ratio of 65.23 percent. The data presented herein, therefore, fully corroborate the theory concerning value added and the assumption underlying a rate of return, not only commensurate with the higher value added ratio but one that is progressively higher. Furthermore, and by the same token, they high light the unfairness and the inequity in applying to a company with a value added ratio of 77.5 percent a rate of return earned by an industry group having a value added ratio of only 46.18 percent.

APPLICATION OF VALUE-ADDED THEORY TO SPECIFIC COMPANIES

As previously noted, there are no data now in possession of the Bureau of Internal Revenue that would make feasible a computation of rates of return on assets for industries classified in the four-digit categories. Such data are available, however, for the three-digit classifications for the years 1946 and 1947 and will soon also be available for the year 1948 and probably in a few months also for the year 1949. It may thus be quite possible and practicable to compute the rates of return at least for the three-digit groups of industries. Until that is done, and perhaps regardless of that, it may be best to compute such rates of return for a specific company in the light of its own experience.

According to the data presented in table 5, during the third year of its operation when it presumably had attained a more or less level of normal operation in this regard (covering the fiscal year ended April 30, 1951), the Morton Gregory Corp. had a value-added ratio or percentage of 77.51. To apply to such a company a rate of return characteristic of a group of industries (major groups 33 and 34) with a value-added ratio of 46.18 percent borders on the ridiculous. To a lesser extent it is also objectionable to apply to it a rate of return characteristic of Industry 349 with a value-added ratio of only 54.15 percent.

TABLE 5.—*Value added by manufacture, Nelson Stud Welding Division only, Morton Gregory Corp. (fiscal years ending Apr. 30, 1949, 1950, 1951)*

	Amounts		Percent of Net sales
Fiscal year ending April 30, 1949:			
Net sales		$1,717,804	
Less—Sales of purchased products and ferrules		160,000	
		1,557,804	
Material and containers	$580,378		
Less—Cost of purchased products and ferrules	86,405		
	493,973		
Supplies	28,723		
Utilities	8,064		
		530,760	
Net value added by manufacture		1,027,044	65.93
Fiscal year ending April 30, 1950:			
Net sales		1,680,032	
Less—Sales of purchased products and ferrules		153,073	
		1,526,959	
Material and containers	492,318		
Less—Cost of purchased products and ferrules	95,450		
	396,868		
Supplies	30,865		
Utilities	8,285		
		436,018	
Net value added by manufacture		1,090,941	71.45
Fiscal year ending April 30, 1951:			
Net sales		2,475,208	
Less—Sales of purchased products and ferrules		291,831	
		2,183,377	
Materials and containers	596,710		
Less—Cost of purchased products and ferrules	172,751		
	423,965		
Supplies	62,245		
Utilities	9,743		
		490,953	
Net value added by manufacture		1,692,424	77.51

Source: Submitted per covering letter dated June 7, 1951 and signed R. J. Kilmer.

The logical and sound thing to do would be to apply to the company the rate-of-return characteristic of its own industry, which in this case is the screw machine products industry in the four-digit classification, or that of comparatives made up of companies similarly operating. In the absence of such data, the company's own experience in relation to that of major industry groups 33 and 34 offers the best practical solution. By the simple process of applying this relationship to the industry base-period rate through the use of a simple formula, the problem is solved. This formula is as follows:

$$\frac{\text{Value added by company}}{\text{Value added by groups 33 and 34}} \times \text{Rate of return for industry groups 33 and 34} = \text{Rate of return applicable to company.}$$

When this formula is translated by use of the necessary data, the results are as follows:

$$\frac{77.51 \text{ percent}}{46.18 \text{ percent}} = 167.84 \text{ percent} \times 13.8 \text{ percent}^{1} = 23.16 \text{ percent}$$

Application of this formula is not only sound in theory. It is also logical and is easily and readily administered to all companies that qualify for relief on grounds provided by the law as amended. That it results at the same time in fair and equitable treatment goes without question.

[1] 13.8 percent is the rate of return applicable to groups 33 and 34 as determined by the Treasury Department for use in computing excess profits.

SPECIAL SIGNIFICANCE OF VALUE-ADDED ADJUSTMENT TO SMALL BUSINESSES

As a rule, small manufacturing corporations engage in processes and operations that may not be susceptible to a very high degree of mechanization and large-scale operation and which require special skills, extra attention to detail, specific designs for individual customer needs, and products and service that are "tailor-fitted" to such needs in an engineering and production way. It is under such conditions that they can compete successfully among themselves and with manufacturers operating on a large scale. All of these spell a relatively high value-added ratio for such small concerns and society, through expressions in the open market, has shown its willingness to pay a fair price for this added contribution. In justice, therefore, this unique contribution of small businesses should be given recognition in determining for them a fair and reasonable rate of return for normal tax purposes. Such a return must necessarily be adequate to insure continued operation of these small businesses, so essential to our economic system. It is felt that application of the formula suggested above will do just that.

Senator MILLIKIN. Our next witness is Mr. Joseph McCloskey. Make yourself comfortable.

STATEMENT OF JOSEPH McCLOSKEY, ARROW FOOD DISTRIBUTORS, INC.

Mr. McCLOSKEY. My name is Joseph McCloskey. I am appearing as one of the organizers and secretary of Arrow Food Distributors, Inc.

The story of Arrow Food Distributors is the story of a really small growth corporation. I believe its story will convince you of the inequity of the provisions of the existing excess-profits-tax law to corportations in our situation.

Arrow Food Distributors is a Louisiana corporation domiciled in New Orleans. It is engaged in the wholesale distribution of frozen food products.

It was organized by seven honorably discharged veterans of World War II and began operations as of April 1, 1947.

It could not have been organized prior to January 1, 1946, because of the service obligations of the incorporators.

Its base period, therefore consists of only 33 instead of 48 months. In those 33 months, though, its growth record has been as follows:

In payroll an increase from $30,000 in the first 9 months of operation in 1947 to almost $110,000 for the 12 months of 1949, better than 3½ to 1.

By 1950 the payroll had gone up to $150,000, and it will approximate $165,000 this year.

I have broken down these figures on exhibit 1 which has been filed with you.

They show clearly that the payroll for the second half of the 33 months of operation was far in excess of 130 percent of the total payroll for the first half of the number of months in operation.

Turning to gross receipts, we find an increase from $384,000 in the first 9 months of operation in 1947 to $1,600,000 for 1949; 1950 gross receipts were $65,000 in excess of $2 million and 1951 gross receipts should approximate 2½ million.

I have also broken down those figures on exhibit 2. They show that we are here again far in excess of the percentage increase in gross receipts during the second half of our base period, which is the measure of a growing corporation.

Now, I have also previously furnished to each member of the committee a memorandum to which I attached a graph. I believe that this graph is a very good illustration of the fact that we are a growing corporation. It is with the blue memorandum there, Senator. It shows that in 1947 there was a growth, but a very gradual growth, during the organization period.

In 1948, 1949, and 1950, however, you can see what our growth experience was up until the time of the hostilities in Korea.

As the graph will show the outbreak of the Korean War had a very adverse effect on our business.

Senator MILLIKIN. How did that come about?

Mr. McCLOSKEY. The explanation for that, Senator, is that at that time consumers in general used their money to stock up on articles which were expected to be in short quantity, but because of limited freezer space, frozen foods were not among those articles, and because the money was channeled off in other directions, the frozen food business suffered a slump.

Senator MILLIKIN. I notice it runs up pretty rapidly.

Mr. McCLOSKEY. Well, it was only after that scare-buying period came to an end that we resumed our normal growth pattern.

We think that we are still going forward, as our 1950 and 1951 experience shows.

Senator KERR. Are you retail or wholesale?

Mr. McCLOSKEY. Wholesale distribution of frozen foods.

Senator KERR. Consisting of vegetables mainly?

Mr. McCLOSKEY. Vegetables, orange juice, chickens, waffles that you put in your toaster.

Senator KERR. You have not got any samples of your wares here, have you?

Mr. McCLOSKEY. No, sir, I do not have, Senator. I asked our president if he did not think we should bring some along. We think that our profits are certainly not in the language of the House report on the excess profits bill, higher than they would have been in the absence of hostilities and a large military budget.

On the contrary, because of this interference with our normal growth pattern, we earned $3,800 less in 1950 than we had in 1949, but nevertheless because the excess profits tax, as now written, prevents us from being recognized as a growing corporation, we are going to have to pay an excess profits tax for 1950 in an amount about equal to our loss in profits, and of course, that is going to be worse for 1951 and future years because for 1950 we compute only on a 6-month, rather than a 12-month basis.

We believe that we have met all the yardsticks set up for determining what is a growing corporation, except that we had not or were not in business prior to January 1, 1946. But when you remember that all seven of the incorporators of this concern were members of the armed services, it is pretty obvious we could not have organized prior to January 1, 1946.

So, as a net result, an organization which makes $3,800 less in 1950 because of military hostilities, has to pay an excess profits tax on almost the same amount, or a net difference in money for future development of a still expanding business, in the neighborhood of $7,500.

We feel that this is an unfair penalty to impose on seven honorably discharged veterans of World War II who were prevented from organizing prior to January 1, 1946, and who should be entitled to some time credit in the application of the excess-profits tax law.

We feel further that although the products handled by Arrow Food Distributors are technically not new products, the tremendous increase in the general distribution of frozen foods since the end of World War II, and the addition to the frozen food line of articles not previously packaged as frozen foods, are additional reasons why we should be treated as a growing corporation. Otherwise, we are not going to be able to stay in competition with the nonveterans whose businesses were organized prior to January 1, 1946, and who have reflected the same growth in the increase in the frozen food business.

The tax money they do not have to put out can be used directly in competition with us, and that is why we think that relief now rather than at a later date is so important.

We submit, therefore, that in view of the percentage increase in volume of sales and in payroll, which we have demonstrated, and also in view of the newness of the general distribution of frozen foods, the excess profits tax law should be amended to permit us to use the alternative method of determining our excess profits tax credit, which is allowed to growing corporations.

We have already furnished each member of the committee a full memorandum with respect to this, including a draft of a proposed amendment to accomplish the result. We earnestly invite your attention and thorough consideration of it.

Senator MILLIKIN. Thank you very much.

(The documents referred to follow:)

Payroll records, Arrow Food Distributors, Inc.

1947—9 months, Apr. 1–Dec. 31	$30,488
1948—First 6 months, Jan. 1–June 30	29,360
Second 6 months, July 1–Dec. 31	43,495
1949—First 6 months, Jan. 1–June 30	43,828
Second 6 months, July 1–Dec. 31	65,904

For the 33 months of business beginning April 1, 1947, and ending December 31, 1949, the corporation thus had a total payroll of $213,075.

For the first half of this period, i. e., for 16½ months beginning April 1, 1947, and ending August 15, 1948, the payroll amounted to $69,989.

For the second half, i. e., from August 16, 1948, to December 31, 1949, the payroll amounted to $143,086.

It is obvious, therefore, that the payroll for the second half of the 33 months during which the corporation has been in business was 130 percent of the total payroll for the first half of the total number of months during which it was engaged in business.

PAYROLL RECORDS SINCE 1949

1950—First 6 months, Jan. 1–June 30	$71,984
Second 6 months, July 1–Dec. 31	78,574
1951—First 6 months, Jan. 1–June 30	84,237

Gross receipts, Arrow Food Distributors, Inc.

1947—9 months, Apr. 1–Dec. 31	$394,307
1948—First 6 months, Jan. 1–June 30	471,471
Second 6 months, July 1–Dec. 31	623,355
1949—First 6 months, Jan. 1–June 30	792,678
Second 6 months, July 1–Dec. 31	893,718

For the first 33 months of business beginning April 1, 1947, and ending December 31, 1949, the corporation thus had gross receipts of $3,175,529.

For the first half of this period, i. e., for 16½ months beginning April 1, 1947, and ending August 15, 1948, the gross receipts amounted to $1,003,814.

For the second half, i. e., from August 16, 1948, to December 31, 1949, the gross receipts amounted to $2,171,715.

From the above it is obvious that the gross receipts for the second half of the 33 months during which the corporation has been in business was 150 percent of the total gross receipts for the first half of the total number of months during which it was engaged in business.

GROSS RECEIPTS SINCE 1949

1950—First 6 months, Jan. 1–June 30	$1, 018, 122
Second 6 months, July 1–Dec. 31	1, 017, 054
1951—First 6 months, Jan. 1–June 30	1, 250, 022

Memorandum Submitted by Arrow Food Distributors, Inc.

Arrow Food Distributors, Inc., was formed by seven veterans of World War II on April 8, 1947. The attached graph, (exhibit A), shows the continuous growth of the corporation in volume of sales. The yearly profit, before taxes, is set out as follows:

Nine months 1947, $487.01; year 1948, $24,015.18; year 1949, $50,070.18; year 1950, $47,101.84.

The graph establishes that far from profiting from the outbreak of the Korean War, the corporation suffered a distinct falling off from the ordinary pattern of growth which it had previously been evidencing, and did not begin its way back toward a continuance of this growth pattern until the beginning of 1951.

That is explained by the fact that, at the outbreak of the Korean War, consumers in general used their money to stock up on articles expected to be in short quantity thereafter. Because of the limited freezer space, however, frozen foods were not among the articles which were purchased in quantity at that time, and it was only after a return to more normal buying habits that this corporation, as shown on the attached graph, began to resume the steady growth pattern previously manifested.

The net profit figures for 1949 and 1950 illustrate further the inequity in applying the Excess Profits Tax Act of 1950, as now written, to this corporation.

In its report to the House on H. R. 9827, the Committee on Ways and Means declared:

"One of the main objectives in imposing an excess profits tax is to reach corporate profits which have been swollen by the increased tempo of the economy. An excess profits tax selects for additional tax those corporations whose profits are higher than they would have been in the absence of hostilities and a large military budget."

As will be noted from the attached graph and the net profit figures set out hereinabove, the profits of this corporation for the year 1950 were not "higher than they would have been in the absence of hostilities and a large military budget," but were, in fact, actually lower than they had been in the previous year.

The profits of this corporation are, therefore, those of one experiencing an unusually rapid growth in payroll and gross receipts which, if not due to the sale of a technically "new product," are unquestionably the result of tremendous increase since the end of World War II in the general distribution of frozen-food products and the addition to the line of frozen-food articles distributed during those years of many products not so formerly packaged and distributed.

However, because this corporation could not have been organized prior to January 1, 1946, because all of its incorporators were in the armed services, it could not take advantage of the alternative method of computing its average base period net income in determining its excess-profit-tax credit which is afforded growing corporations under the Excess Profits Tax Act of 1950.

Instead, it is relegated to the unsatisfactory alternative of determining this credit either on the basis of its income during the base period (during which there was no income for 12 months in 1946 and 3 months in 1947), or by use of the industry rate of return proclaimed by the Secretary of the Treasury for new corporations.

Under either alternative this corporation's excess-profits-tax credit will not exceed the minimum $25,000 credit allowed under the act. As a result, although it has a smaller net profit in 1950 than in 1949, it will be subjected to the imposition of an excess-profits tax on its 1950 operations. If its growth pattern continues it will be subjected to an even greater excess-profits tax in subsequent years.

On the other hand, as a growing corporation this corporation would be entitled to use its excess-profits net income for 1949 as its average base period net income in computing its excess-profits-tax credit, with the result that its excess-profits tax, if any, would be negligible.

It would thus seem apparent that the Excess Profits Tax Act of 1950, by providing to this corporation only the alternative relief given to new corporations, does not sufficiently take into account the unusually rapid growth, expansion, and development of the business of distributing frozen foods since the cessation of hostilities of World War II, and by its designation of January 1, 1946, as the date before which a corporation must have been in business in order to avail itself of the alternative relief permitted to growing corporations, unjustly penalizes corporations composed of veterans of World War II whose military service prevented them from incorporating a business prior to January 1, 1946.

It is therefore submitted that there is a hiatus in the Excess Profits Tax Act of 1950 as now written under which a technically new corporation, which has in fact the characteristics and meets the tests of a growing corporation, but cannot technically qualify as such because its members, all veterans of World War II, were not in a position, on account of their military and naval service, to begin business prior to January 1, 1946, is subjected to the payment of an excess-profits tax for 1950 on an amount of profit less than that earned in 1949.

A suggested amendment to the Excess Profits Tax Act of 1950, which would permit corporations such as Arrow Food Distributors, Inc., to avail themselves of the alternative relief provided to growing corporations, although technically a new corporation, is set out hereunder.

This proposed amendment continues in effect fundamental yardsticks for determination of the rate of growth required for use of the alternative basis for growing corporations now provided in the Excess Profits Tax Act of 1950. Its only effect is to permit a corporation composed of veterans who could not organize their business until after January 1, 1946, but who otherwise meet the test of a growing corporation, to use the alternative means provided to such corporations for computing their excess profits tax credit.

The proposed amendment is as follows:

1. Amend Section 435 (b) to read as follows:

"BASE PERIOD.—As used in this subchapter the term "base period" means the period beginning January 1, 1946, and ending December 31, 1949, except that (1) in the case of a taxpayer whose first taxable year under this subchapter was preceded by a taxable year which ended after December 31, 1949, and before April 1, 1950, and which began before January 1, 1950, the term "base period" means the period of 48 consecutive months ending with the close of such preceding taxable year; and (2) in the case of a taxpayer entitled to the benefits of subsection (ee) the term "base period" means the period of months beginning with the first day of the month on which the corporation commenced business, and ending with December 31, 1949."

2. Add to section 435 a new subsection reading as follows:

"(ee) AVERAGE BASE PERIOD NET INCOME—ALTERNATIVE BASED ON GROWTH

"(1) TAXPAYERS TO WHICH SUBSECTION APPLIES.—A taxpayer shall be entitled to the benefits of this subsection even though it did not commence business before January 1, 1946, if

"(A) (i) It began business prior to July 1, 1947; and

"(ii) Both at the time of its incorporation and at the close of its first taxable year under this subchapter, at least 70 per centum of its total outstanding voting stock was owned by veterans of any of the branches of the Army or naval services of World War II who were separated from said service under conditions other than dishonorable; and

"(iii) The total assets of the taxpayer as of December 31, 1949 (when added to the total assets for such day of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter), determined under paragraph (3), did not exceed 35,000,000; and

"(iv) The total payroll of the taxpayer (as determined under paragraph (e) (4)) for the last half of the total number of months during which it was in business prior to the beginning of its first taxable year under this subchapter is 130 per centum or more of its total payroll for the first half of the aforesaid total number of months, or the gross receipts of the taxpayer (as determined under paragraph (e) (5)) for the last half of the aforesaid total number of months is 150 per centum or more of its gross receipts for the first half thereof.

"(B) (i) The taxpayers' net sales for the period beginning January, 1 1950, and ending June 30, 1950, when multiplied by two, equals or exceeds 150 per centum of its average net sales for the first half of the total number of months during which it was in business prior to the beginning of its first taxable year under this subchapter; and

"(ii) 40 per centum or more of the taxpayers' net sales for the calendar year 1950 is attributable to a product, or class of products (including any article in which such product or class of products is the principal component, and including any article which is a component of such product or class of products), of a kind not generally available to the public at any time prior to January 1, 1946, and

"(iii) The amount of the taxpayer's net sales which is attributable to such products or class of products for the first 12 months during which the taxpayer was in business is 5 per centum or less of the amount of its net sales (as defined in paragraph (e) (B) (iii) so attributable for the 12 months immediately prior to the beginning of its first taxable year under this subchapter."

3. Amend the first sentence of section 435 (e) (2) to read as follows:

"The average base period net income determined under this subsection and subsection (ee) shall be determined as follows:"

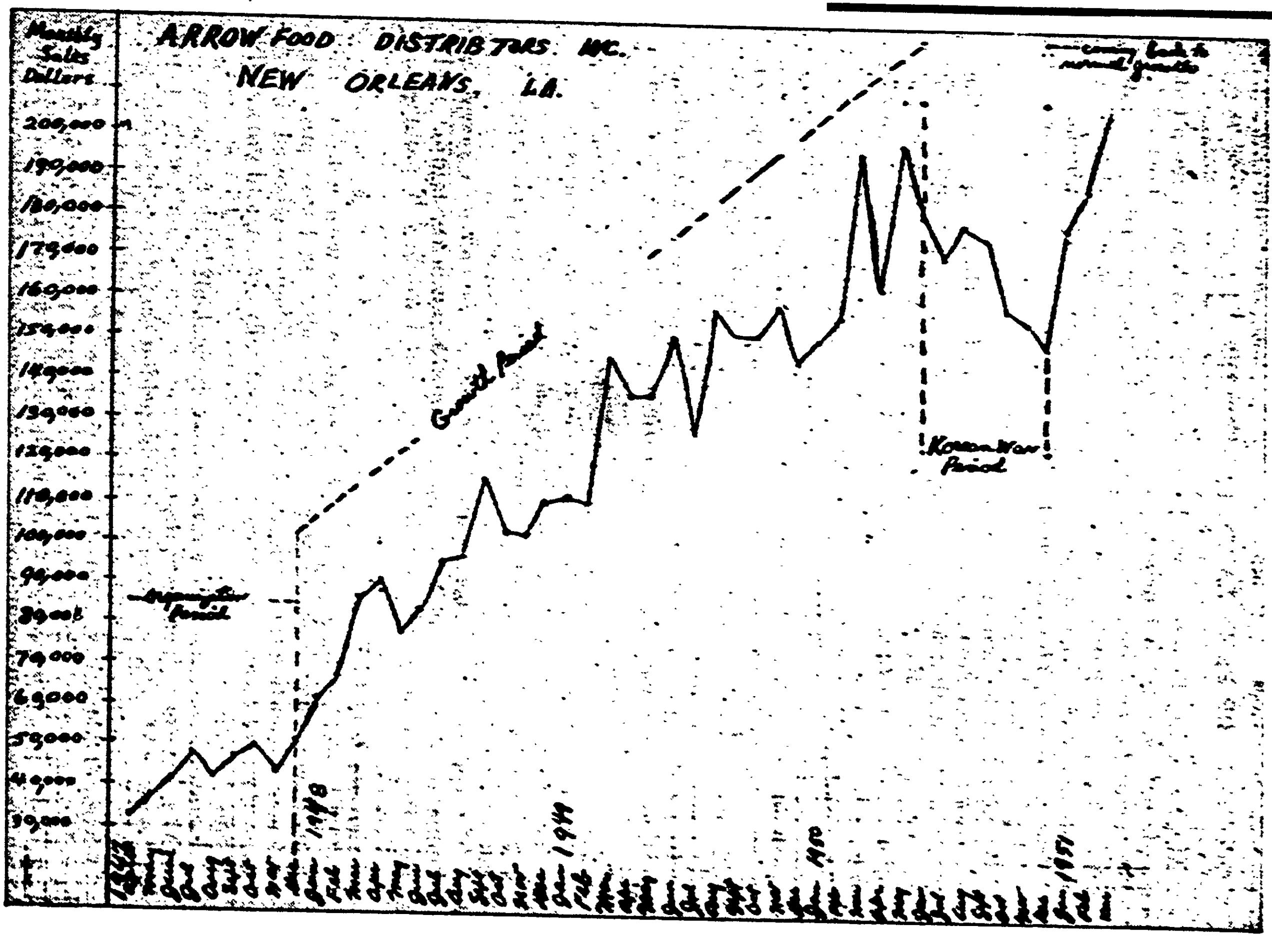
4. Amend the first paragraph of section 435 (e) (2) (G) to read as follows:

"In the case of a taxpayer who is entitled to the benefits of this subsection or subsection (ee) only under paragraph (1) (B) and whose excess profits net income for the calendar year 1949 is not more than 25 percentum of its excess profits net income for the calendar year 1948, by computing—"

5. Amend the last paragraph of section 435 (e) (2) to read as follows:

"The average base period net income determined under this subsection or under subsection (ee) shall be the amount ascertained under subparagraph (C), (D), or (F), whichever is the highest, except that in the case of a taxpayer described in subparagraph (G) its average base period net income determined under this subsection shall be the amount ascertained under subparagraph (C), (D), (F), or (G) (ii), whichever is the highest."

6. Amend section 435 (e) (3), (4), and (5) to make them apply both to subsection (e) and subsection (ee).


ARROW FOOD DISTRIBUTORS INC.
NEW ORLEANS, LA.
Monthly Sales Dollars
200,000
190,000
180,000
170,000
160,000
150,000
140,000
130,000
120,000
110,000
100,000
90,000
80,000
70,000
60,000
50,000
40,000
30,000
Growth Period
Korean War Period
coming back to normal growth
1948
1949
1950
1951

Senator MILLIKIN. Our next witness is Felix Lapeyre. Will you please come forward and give your name and connection to the reporter.

STATEMENT OF FELIX LAPEYRE, REPRESENTING PEELERS, INC.

Mr. LAPEYRE. Senators, we have essentially a very acute, but simple problem which I believe we can present in a very short time. My client, Peelers, Inc., was incorporated in 1949 for the purpose of exploiting some patents on shrimp peeling machines. Formerly shrimp were peeled manually, and it was a very costly operation.

Senator KERR. You mean by hand?

Mr. LAPEYRE. By hand.

Senator KERR. Yes.

Mr. LAPEYRE. Now, you will note on the last three pages of the memorandum submitted photographs of these machines from which you may see that the machines are not something which were dreamed up overnight, but are a combination of inventive genius and engineering skill.

Senator MILLIKIN. Where do you operate your business?

Mr. LAPEYRE. We operate in the State of Louisiana, principally in the parishes of Terrebonne and Orleans, and Jefferson.

As a matter of fact, as I was saying, Senators, it took a period of approximately 6 years to develop the machines to the stage in which they now are.

There are three patents on the machines already issued and one further patent will shortly be—one further patent application will shortly be filed.

The way we handle these machines is this: We manufacture them, but we do not sell them. We lease them to the shrimp operators.

There are only two types of shrimp, as of now, which are peeled commercially. They are the canned shrimp, of course, and what is known in the industry as the cooked-peeled shrimp

The cooked-peeled shrimp are blanched, as we call it, which is a boiling operation for just a couple of minutes in a brine solution, and then the shrimp are placed into a large, what I would call, paint can.

Senator KERR. What?

Senator MILLIKIN. Paint can.

Mr. LAPEYRE. In a paint can. I mean, a can with a lid which flops down, but which is not hermetically sealed, and they are kept under refrigeration, and sold in that state. They are different from canned shrimp which are, of course, hermetically sealed, and processed inside the can.

Senator MILLIKIN. They are completely cooked?

Mr. LAPEYRE. That is right.

Senator MILLIKIN. You are just blanching these?

Mr. LAPEYRE. The cooked-peeled, are simply blanched.

Senator MILLIKIN. All right.

Mr. LAPEYRE. Those are the only two types of shrimp which are peeled before being commercially sold, and they are the types of shrimp which we peel on our machines.

As I said, we do not sell the machines, we lease them to various shrimp operators, at a rental which approximates $4 a barrel on the shrimp which are introduced into the machine.

Senator MILLIKIN. How much would it cost to do the job by hand?

Mr. LAPEYRE. It would cost in excess, I believe, of twice that amount when various other factors are taken into consideration, such as the mutilation and loss of shrimp meats by hand peeling, which is largely eliminated by the machine peeling.

As a matter of fact, I think the attractiveness of the machines is shown by their success.

In 1949 there were only token operations. We only had one pilot machine at that time. Our operations were practically nil.

But in 1950 we had in operation over the period of that year an average of 16.81 machines, which grossed a rental of approximately $9,000 per machine.

Senator KERR. Per year?

Mr. LAPEYRE. Per year. The net earnings for 1950 were $150,000.

Thus far in 1951, 28 machines have grossed a rental of a total of $151,000, with the big August-September season just coming on.

Now, this excess-profits-tax situation: We do not have any base period experience. Our capitalization is low, so we are relegated to the industry rate of return as the possible means of figuring our excess-profits-tax credit.

Now, we have created a new industry, and find ourselves placed into a classification which is entitled, "Miscellaneous Business Services," which, for all I know, may include some corporation for bootblacks, or something of that sort, which has a rate of return of 13.3 percent.

Actually we, in the year 1950 had a return of 85 percent on our combined invested and borrowed capital, so that you can see that to apply a return of 13.3 percent to a business which is actually earning 85 percent is, to say the least, not very realistic.

Senator KERR. And it was not a war profit.

Mr. LAPEYRE. It was not a war profit.

As a matter of fact, Senator, and I am very happy you brought that up, if anything, our experience is that our earnings now are less than they would have been in the base period for several reasons.

Senator KERR. First of all, there were a lot more shrimp.

Mr. LAPEYRE. There were a lot more shrimp.

Evidently you are familiar with the shrimp situation.

No. 2. We could have expanded more rapidly in that period because now we are faced with shortages of aluminum. Our machines are made largely of aluminum, and it is hard to get, so our experience has been that our expansion has been and probably will continue to be hampered in that regard.

Senator MILLIKIN. What do you want to do?

Mr. LAPEYRE. Well, the effect of the law as it presently stands, upon us, is that we are paying currently 62 percent, the ceiling tax, you see, upon our income.

Senator MILLIKIN. What do you propose?

Mr. LAPEYRE. If that is raised to 70 percent, we would be paying that. Feeling that the spirit of the excess-profits-tax law is to exempt from this additional tax all income which is not produced by the current inflationary trend due to the war emergency, we propose an exclusion from excess profits tax net income of income which is obtained by reason of patents on a patented article which was not available at the inception of the base period to the extent, however, only that such income has not been swollen by war contracts or by price increases since the particular article first became generally available.

Senator MILLIKIN. Are you familiar with this problem, Mr. Stam?

Mr. STAM. I had talked to the gentleman about his problem.

Senator KERR. What you say is that you really are entitled to have established that which would in actuality be a normal base for your business.

Mr. LAPEYRE. That is absolutely correct.

Now, late in the spring—last May, I prepared a memorandum and sent it to all the members of the House Ways and Means Committee and also to all the members of the Senate Finance Committee, and a copy to Mr. Stam.

At that time, I proposed a type of 722 approach whereby we would be thrown back into the economic conditions existing in the base period, and we would work it out on that fashion. I was told that Congress was not at all anxious, as a matter of fact, was rather bitterly opposed to, reenacting a 722 type of approach, which at least theoretically, is the just type of approach, but which has a lot of bugs in administration—it is very difficult of administration.

Senator KERR. What you are saying to us is that if you are going to be put into a miscellaneous classification you would like to see it one that would produce equity rather than inequity.

Mr. LAPEYRE. That is exactly it, Senator.

We are also in this very precarious position. We have borrowed the capital to manufacture these machines. That capital must be repaid out of earnings. Now if Uncle Sam comes in every time our machine lays a golden egg and snatches that egg away from us, we are going to find it very difficult to repay the money we have borrowed and have any return at all on the work and inventive genius which has been expended in the development of these machines.

Senator KERR. In other words, the situation is going to develop where either the fellow who furnishes the money from which you made the machines, or Uncle Sam is going to take it?

Mr. LAPEYRE. That is exactly it.

Now we thought of getting around the whole problem by liquidating and operating as a partnership, assuming personal, individual liability with respect to the heavy borrowed indebtedness of the corporation. The trouble there is that in an ordinary liquidation——

Senator KERR. The trouble there is that your liquidation would be a taxable transaction, and rather than getting relief you would just accelerate the process.

Mr. LAPEYRE. We would be putting a noose around our necks taxwise.

Senator KERR. I would not advise you to do that.

Mr. LAPEYRE. Unless we can liquidate under section 112 (b) (7) whereby we postpone the realization of a capital gain on the appreciation of capital, as I understand. The only trouble about that is that we must do it right now, we have got to do it pronto, and it is for that reason, Senator, ——

Senator KERR. I thought that provision was good for any part of 1951?

Mr. LAPEYRE. That is right. We have got to do it before the end of this year.

Senator KERR. Yes.

Mr. LAPEYRE. Unless the Senators and the Congress want to extend that provision for another year; we do not want to liquidate. We prefer the corporate form. It is a lot more convenient. The shareholders have minor children. If we are operating as a partnership the death of one of the partners is going to create complications. We do not want to go into a partnership. We are more than glad to pay the Government a reasonable tax for taking advantage of the corporate form. However, we cannot go on giving Uncle Sam practically everything. So if we do not have relief now, Senators, I do not mean next year or when a general revision of the excess-profits-tax law is considered, if we do not have relief now we are compelled to liquidate now, and that is our situation.

Senator MILLIKIN. I think you have made your point very clear.

Senator KERR. You surely have.

Mr. LAPEYRE. Thank you.

Senator MILLIKIN. Your statement will be put in the record.

(The prepared memorandum referred to is as follows:)

MEMORANDUM SUBMITTED ON BEHALF OF PEELERS, INC.

To the Honorable the Members of the Committee on Finance of the United States Senate:

Peelers, Inc., was formed on January 4, 1949, to exploit the invention of a shrimp peeling machine upon which one United States patent had already been granted and upon which two more patent applications had been filed, both of which have since been granted.

Since that time the corporation has developed an auxiliary shrimp-cleaning device for use with the machine and has, through the individual inventors, filed a patent application thereon.

The machines serve a very useful function in connection with shrimp which are peeled before processing as is done in the case of canned shrimp and cooked-peeled shrimp. They enable shrimp operators to conduct their business at a reduced cost and with greatly increased efficiency. Photographs of the machines are attached so that the members of the committee may see for themselves that the corporation's machines are not simple gadgets, but complex pieces of mechanism resulting from a combination of inventive genius and engineering skill.

The corporation constructs the machines (at a cost of approximately $6,000 each) and leases them to shrimp operators for a rental calculated to approximate $4 per barrel of raw unpeeled shrimp introduced into the machines.

Since it began business the corporation has constructed and leased 28 machines, all now equipped with the newly developed auxiliary cleaning device. Still in its growth period, the corporation must construct many more machines in order to supply all operators desiring to convert from the costly and wasteful manual peeling of shrimp to the economical and efficient mechanical operation.

The whole theory of the Excess Profit Tax is to impose the additional tax only upon corporate incomes which have become swollen by inflation and war-emergency profits. It is designed to supplement renegotiation as a means of taking excessive profit out of the war effort. Only secondarily is it a revenue measure because, if revenue were the primary concern, it could be more efficiently raised by further increases in the normal and surtax rates on corporations and individuals.

In the memorandum submitted to each member of the committee in May, it is shown that none of the profits of the corporation were due to the current inflation produced by the war emergency. We will not repeat the reasons set forth in the May memorandum in support of this statement, but direct the Senator's careful attention thereto.

It may be somewhat surprising to the committee to learn, however, that despite the care and effort of the Congress to incorporate complex relief provisions to exempt noninflation produced income from the additional tax, this corporation is actually subject to the present ceiling tax of 62 percent. How this result obtains will become clear as the pertinent provisions of the act are analyzed.

The corporation has a very low capitalization, having financed the construction of machines by means of borrowed capital, and, of course, has no base period earning history. Accordingly, it must rely upon the "relief" provided for new corporations by section 445 of the Internal Revenue Code.

This "relief" consists of an alternative computation of average base period net income by application of a fixed industry rate of return to the taxpayers' assets. The same relief is granted to five other categories of subnormal base period income.

As the Senators well know, the "industry rate of return" relief subdivides all business into 64 classifications for each of which the Secretary of the Treasury is required to fix tentative and final rates of return by averaging the rate of return of businesses within each classification as disclosed by income tax returns of businesses within each classification for the base years.

On its face, the "industry rate of return" theory gives at best only a crude approximation of the normal income producing capacity of any single taxpayer. It utterly ignores numerous variations in the nature of products or services within each classification. No account is taken of the differentials in size of the individual taxpayers nor of such material factors as advantageous geographical location, degree of risk and management efficiency. The theory makes no provision for intangible values, such as patents, brought in by the shareholders. By applying the average return of taxpayers within a group to all within the group, it patently penalizes the above-average business and confers a tax subsidy upon the below-average business. It places a premium upon inefficiency and mediocrity.

In the case of Peelers, Inc., the result obtained has the color of absurdity Having created a new industry, the corporation falls within no well-defined classification but is lumped into a catch-all classification entitled "Miscellaneous Business Services" for which the Secretary of the Treasury has proclaimed a tentative rate of return of 13.3 percent.

The corporation earned over $150,000 during the year 1950 on a combined invested and borrowed capital of $174,000, an actual return of over 85 percent. To apply a normal rate of 13.3 percent is manifestly unrealistic.

In view of the inadequacy of the industry rate of return in this instance, the corporation is subject to the ceiling tax of 62 percent, now raised in the House bill to 70 percent, in spite of the fact that none of its income represents war or inflation earnings. Handsome as the corporation's profits are, the shareholders are faced with the prospect of retaining only 30 cents out of every dollar earned. After providing for repayment of borrowed capital (which it is obligated to repay within 10 years) and for the future expansion of its operations, little or nothing of this 30 cents will remain for distribution as dividends. Yet, since the income-producing factor of the business is patent protection, the shareholders must make their profit during the limited life of the patents. Unless relief is forthcoming, the shareholders' profit will be small indeed.

Faced with this situation the shareholders of the corporation must either obtain prompt and complete statutory relief or liquidate the corporation and operate as a partnership, thus avoiding all corporate taxes.

The statutory relief must come now, not next year, because, in order to avoid a ruinous capital gains tax on liquidation by reason of the appreciation in value of the patent rights, the shareholders must take advantage of section 112 (b) (7) allowing postponement of the realization of the capital gain in event of a complete distribution of the corporation's assets within one calendar month of the year 1951.

It is to be observed that unfair and discriminatory taxation upon corporations inevitably induces businesses to avoid or shed the corporate form. Thus Government loses the corporate taxes it might otherwise collect. Even little geese, laying little golden eggs, should not be thoughtlessly slaughtered.

As will appear from the memorandum submitted to each member of the committee in May, the corporation felt that a reworking of the relief provisions of the act was indicated. It accordingly suggested the addition to the Excess Profits Tax Act of a modified "section 722" provision. I am informed by the committee's tax adviser, Mr. Colin Stam, however, that such a provision could not be considered at this time.

In accordance with Mr. Stam's suggestion, therefore, the corporation now proposes a more specific type of relief to serve as a stopgap until a more extensive revision of the act can be undertaken by the Congress. A copy of the proposed relief provision is attached hereto.

The relief proposed would exclude from excess profits tax net income, 85 percent of income derived from patented devices not available to the public at the inception of the base period to the extent that such income has not been swollen by war contracts or by inflationary price increases. Its technical merits can best be explained to the committee by Mr. Stam or by one of the committee's other technical experts.

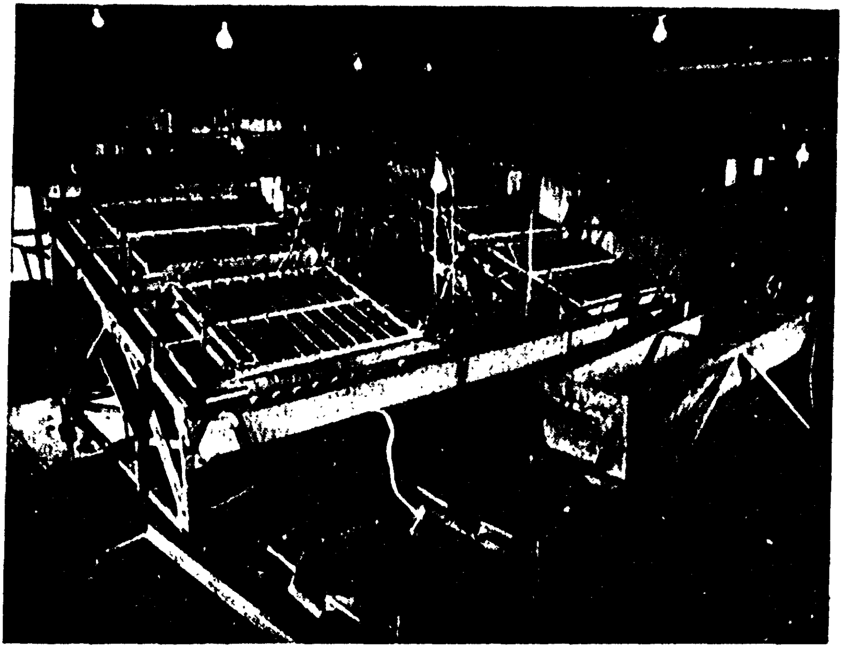
Although the proposed amendment obviously fails to equalize all the inequities inherent in the act, it is in keeping with the spirit of the law which is to exempt from the additional tax, corporate income which has not been produced by the current inflation. It provides relief to those corporations whose need for relief is most acute—corporations having no base period history whose income producing factor is patent protection with a limited life of 17 years. Its adoption is respectfully urged.

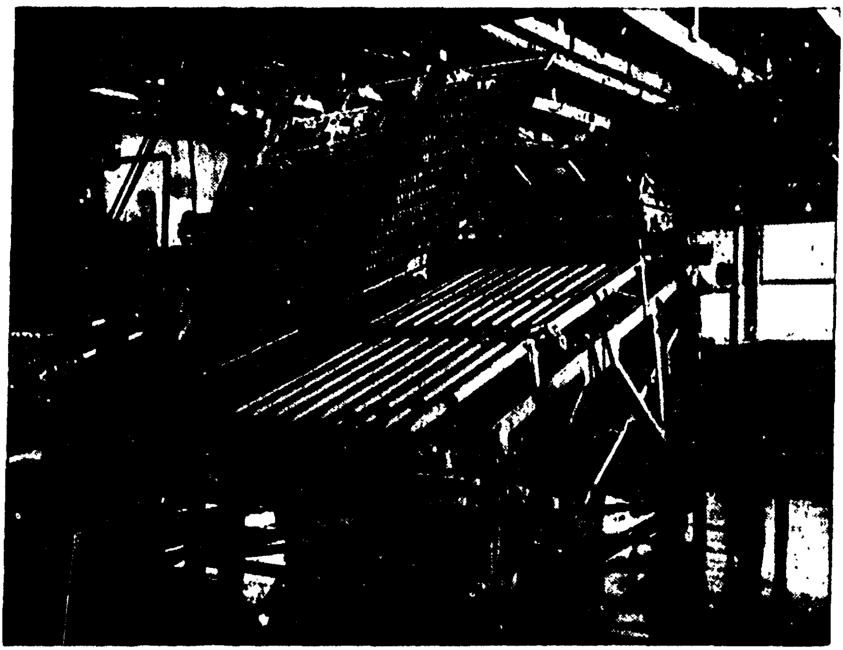
PROPOSED ACT

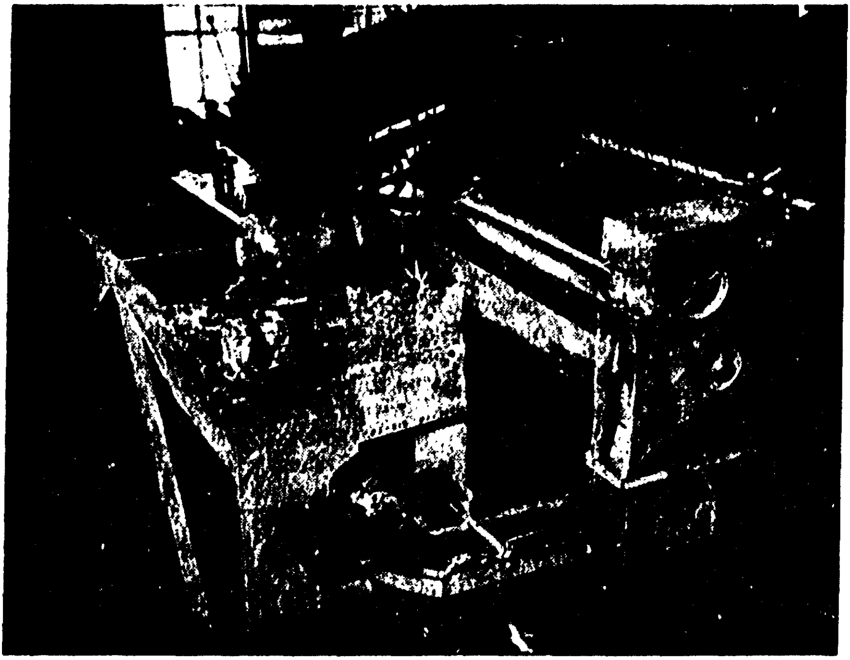
(a) Section 433 of the Internal Revenue Code is hereby amended to add the following sub-subparagraph (R) to subparagraph (1) of paragraph (a) of said section:

"(R) There may at the election of the taxpayer be excluded in computing the excess profits net income of any corporation 85 percent of the difference between (I) the total gross receipts (including damages collected under an award or by compromise on account of infringement) derived during any taxable year under this subchapter from sale or lease of a patented article or from performance of a service by use of a patented article, if such patented article or such service performed by use thereof is of a kind not generally available to the public at any time prior to January 1, 1946, and (II) the sum of: (i) such portion of such gross receipts as was received as a result of contracts or subcontracts of the taxpayer with the United States or any agency or instrumentality thereof; (ii) such portion of such gross receipts (exclusive of amounts received in the manner set forth in (i)), as was received as a result of any increase in the price, rental or other remuneration charged in connection with the sale or lease of such patented article or in connection with the performance of such service by use of such patented article, since the time such article or service was first made generally available; and (iii) such portion of any costs or deductions relating to such gross income allowable in determining the normal-tax net income for such taxable year as is proportionate to the ratio between the total of such gross receipts decreased by the amounts set forth in (i) and (ii) and the total of such gross receipts; provided that, should any corporation elect to receive the benefit of this exclusion for any taxable year under this subchapter, the excess profits credit of such corporation computed under section 434 for such taxable year shall be reduced to an amount proportionate to the ratio between the excess profits tax net income computed with benefit of the exclusion and the excess profits tax net income computed without benefit of the exclusion. The term "patented article" shall include articles designed and built substantially in accordance with an application for patent; provided that, if such application for patent be ultimately disallowed or abandoned, the tax liability of the taxpayer shall be recomputed without benefit of any exclusion based upon such application for patent."

(b) This amendment shall be effective as of the date of enactment of the Excess Profits Tax Act of 1950.







Senator MILLIKIN. Mr. Oxley?
Make yourself comfortable, Mr. Oxley.

STATEMENT OF JOHN T. OXLEY, PRESIDENT, TEXAS NATURAL GASOLINE CORP.

Mr. OXLEY. Mr. Chairman, and members of the Finance Committee, my name is John T. Oxley. I live and work in Tulsa, Okla. I am president of the Texas Natural Gasoline Corp., capitalized at $100,000 and organized in 1948.

We are a small, young business, processing natural gas, whereby we produce three principal products: Natural gasoline, butane, and propane. These products are derived from gas taken from producing oil or gas wells, which gas otherwise could not be utilized. Our equipment extracts the liquefiable hydrocarbons eliminating the water and sulfur, and producing usable fuels which otherwise would be lost as escaped gas.

Senator KERR. What you mean by that is that your equipment extracts natural gasoline, the liquid butane, and the liquid propane, and then eliminates the damaging refuse which is water and sulfur and you have left the residue of clean, highly valued natural gas.

Mr. OXLEY. Which is sold to the public utility company for use in the homes.

This gas was for a number of years vented into the air and wasted throughout the oil fields.

Let me make the point that while we process natural or casing-head gas, we are not manufacturers, nor oil producers. We have the depletion hazard in our business, to the extent that the petroleum reserves upon which we depend for our raw product are in the constant process of depletion, thus reducing the potential revenue of our plants, but we do not have the 27½ percent depletion allowance which applies to oil and gas producers, and which is necessary to the continued progress and growth of the oil industry.

Our tax position is exactly the same as that of a manufacturer of farm equipment or a processor of insecticides though our raw materials position is much less stable.

Senator KERR. That is because you have to locate your plant near the source of supply, which is constantly being depleted, and when gone, then you have to pick up the plant and move it rather than being able to get some more raw product and bring it to it.

Mr. OXLEY. Exactly right. The uncertainty of the reserves is a very great hazard in our business.

Senator MILLIKIN. I think it should be noted that the Senator, in addition to knowing about shrimp, also knows about the gas business.

Mr. OXLEY. Yes, sir; I appreciate that fact.

My company entered into this business at a time when prices of the products we process were at their peak. They have undergone a 35 percent reduction since then. I mention this to illustrate that we are not riding high on a lush and inflated market; on the contrary, we are still doing business and by hard work and what we hope is good management are making a profit in a market which has declined an average of 12 percent each year that we have been in business.

If I may be permitted one personal reference in this statement, let me state that my experience in the natural gasoline business has extended over the past 20 years, 17 of which were spent working for others. Three years ago I realized the great American dream to which I believe every ambitious young man is entitled—going into business for myself. It is my considered opinion that this country's future potential industrial greatness is directly dependent upon the continued presence of the opportunity for young men to realize this dream.

Our company, in spite of the market situation under which we have done business, has enjoyed moderate success, helped insofar as we could to increase the Nation's supply of fuel, given employment to several scores of people, and, incidentally, has produced at least its share of taxable revenue. The critical question for this organization now is whether under the tax situation created it shall be allowed to succeed or even remain in business.

Under the present excess profits tax law, our company is unable to retain enough of its normal earnings to continue to grow and expand or even hold its own, to say nothing of paying off indebtedness contracted prior to the enactment of the present excess profits tax law. It is axiomatic that a new business cannot remain static; we must either progress or fall by the wayside. This principle has already been recognized by the Congress in the enactment of the excess profits tax law last fall, when the growth company formula was evolved to give relief to companies which had not yet had the chance to undergo their normal growth period. Continued growth and expansion is vital to our business, since our processing operations must continue to expand to fresh sources of raw material when the supplies of casinghead gas decline in fields presently supplying our plants.

I would like to make two points. First, the revenue bill now under consideration by this committee proposes an increase in the maximum tax rates above the present limitation of 62 percent. It is generally conceded that any increase in the tax burden above this point would be economically unsound and dangerous, not only as it might affect any one company but as it affects our economy as a whole. My own company's financial structure affords a graphic demonstration of a normal situation for a young, growing company of its age in which the addition of a few more straws in the form of added taxation may well break the proverbial camel's back.

The other point is this: Why did Congress define a growth company as one incorporated prior to January 1, 1946? Why is growth relief denied a company which has all the characteristics of a growth company except incorporation prior to January 1, 1946?

Senator KERR. Mr. Chairman, I wish to join in asking the question, and one that I think the committee should have the information —

Senator MILLIKIN. Maybe Mr. Stam can enlighten us.

Mr. STAM. Well, the only point is that you have to have some period to measure growth, and where you start very late in the base period, and you are looking just at the base period, you do not have anything to measure the last part of the period with, you see, and if you were in business all during the base period you have the first part of the base period to measure with the last part to determine growth. That was the general thought, I think, back of it.

Mr. OXLEY. Mr. Stam, I would like to ask another question.

Suppose this situation may continue, the defense preparation, for another 8 or 10 years, as has been predicted by some of our authorities, what then about new corporations that are formed now in 1951 and 1952? Our problem is that we are having to compete with companies that have a very high base period when prices of our product were at their peak in the years 1946, 1947, and 1948.

I mentioned previously that after we got going in 1949 our prices dropped 35 percent.

Senator KERR. Your company has every characteristic that a growth company has or could have, except that it cannot qualify under the law in that it was not incorporated prior to January 1, 1946.

Mr. OXLEY. Right, Senator.

Senator KERR. Of course, there are bound to be hundreds, there are bound to be thousands, of others in this country in a similar situation, and in which there is no necessary connection or even actual connection with the war effort.

Senator MILLIKIN. I agree with the Senator.

Mr. STAM. You have had two cases here this morning already.

Senator KERR. We had one yesterday, which was a very dramatic one.

Senator MILLIKIN. When we considered the excess-profits tax matter, we considered the case, where neither this committee nor the House Ways and Means Committee here in Congress, in the time available to them, were able to figure out what would be an equitable formula, but you are certainly presenting an important problem to this committee.

Mr. OXLEY. Thank you, sir.

It cannot be presupposed that all companies formed after that date are "war babies" nor that their profits are automatically excessive, nor that their earnings are attributable to war preparations.

In fact, our prices will indicate that for our products. What is the difference between a growth company formed in December 1945 and one formed in February 1948 that relief should be granted to one and denied the other?

It surely cannot be a national policy to deny normal growth and expansion to any and all companies formed subsequent to a date 4½ years prior to the Korean outbreak, yet that is the practical effect of this law. My company is an example; the company has had only 3 years of operation, and its growth curve indicates that it is far from having reached the peak of its normal growth, yet it is subject to taxation at the maximum rates applicable to the largest companies in the land.

Under this tax structure, we cannot continue to do business nor expand at a rate sufficient to counteract our constantly depleting sources of supply without which we cannot hope to long survive, nor can we find venture capital to permit such expansion.

Sources of risk capital have said this to us, in so many words: "We feel that you know your business and we are willing to back your ability to make an adequate profit on additional investment, but under the present tax structure we see no way in which you can retire your present bank loans, to say nothing of repaying additional capital investment which your company needs."

The insolvency of new companies having any considerable indebtedness is almost certainly assured by the imposition of the present rate of taxation which was not contemplated by the companies nor their creditors at the time the obligations were incurred.

Today our company owes substantial sums which it borrowed in 1948 and 1949 to carry on and expand our business.

Senator MILLIKIN. Has it borrowed money since then?

Mr. OXLEY. We have borrowed some money since then, Senator, a small amount.

Senator MILLIKIN. I do not want to intrude into your business unnecessarily, but when did you borrow that money?

Mr. OXLEY. Practically all of our borrowing was completed before the fiscal year ended August 1950, or fiscal year end of 1950.

Senator MILLIKIN. Very well. And very little since then?

Mr. OXLEY. I believe none whatever; I believe that was the last. That is correct.

Senator MILLIKIN. Thank you.

Mr. OXLEY. These were sound loans, made by sound lending institutions, loans which we could repay out of earnings under the tax rates as they were when the loans were contracted.

Under the present excess profits tax law, we cannot retain enough out of earnings to amortize these obligations in any acceptable manner.

I suggest that the following relief would give new companies, which are necessary to the continued industrial health of our country, the chance every company deserves to survive and achieve its normal growth. I submit that this policy would be in harmony with the already voiced philosophy as expressed in the growth company provisions of the present law, from which new companies are now excluded.

1. Extension of the growth formula to companies which show, during their earnings experience, a growth curve comparable in rate of growth to the definitions contained in the present growth company provisions, regardless of their date of incorporation.

2. Permit the use, as a base period for computing excess profits tax credit, a company's best 12 months prior to each tax year, either actual earnings experience or a projected rate based on a partial year's experience of not less than 6 months.

3. Exempt from taxation at excess profits tax rates payments on indebtedness contracted prior to July 1, 1950, and after January 1, 1946.

4. Grant new companies a growth allowance of 20 percent of earnings during each of their first 5 years of operation, providing the sum thus exempt is spent on capital expansion or improvements.

Senator KERR. You mean whether purchased subsequent or prior?

Mr. OXLEY. Yes, sir.

Senator MILLIKIN. Let me ask you this: Suppose on the date that you went into business some man across the street went into exactly the same business and on the same scale, but he had sufficient capital to finance himself completely, whereas you had to borrow money. Does your formula work any kind of discrimination against him?

Mr. OXLEY. No, it would not—I believe not, Senator. He would be faced with realizing——

Senator KERR. He would receive the same benefit that you would.

Mr. OXLEY. That is right.

Senator KERR. Where you at the present time want to take the money that you make and can save from taxation to use to pay the banks back that loaned you the money to expand, that fellow would be reimbursing his capital account which he had drawn on to expand?

Mr. OXLEY. That is right, yes, sir.

Senator MILLIKIN. He would not be under the same pressure which might be destructive pressure, that you would be under.

Could he argue that "I fashioned my own affairs in a way where I escaped these pressures, and it is a competitive advantage to which I am entitled under the American system?" I am just playing devil's advocate here for a moment.

Mr. OXLEY. Yes, surely.

Senator MILLIKIN. It is, therefore, his argument, "I should continue to retain my advantage."

Mr. OXLEY. Well, Mr. Chairman, I might make this observation with respect to your statement. This is a fairly hazardous business. It is a fairly expensive business and requires a million dollars or more to build an average-sized plant.

Senator MILLIKIN. Yes, sir.

Mr. OXLEY. The average individual does not go around with a million dollars in his pocket to put in a gasoline plant. There are other investments that an individual having a million dollars would probably prefer investing in.

Senator MILLIKIN. In most cases if you found that kind of a situation you would find a long-established company, you would not find it in a new venture.

Mr. OXLEY. Yes; that is correct. You would find it with a company that had made their money previously before high tax rates, sir.

Senator KERR. The application of that principle, however, would fix it so that only he who had the necessary cash could go into business, and it would just close the door to the fellow who had everything else but capital, who had somebody who was willing to loan it to him, provided he was in a position to pay it out of what he made.

Mr. OXLEY. That is correct.

Senator MILLIKIN. If you want to be completely philosophical, it is not the function of the excess-profits-tax bill to iron out any competitive inequality, but I am not pursuing that. I have great sympathy for the predicament you find yourself in, and others who find themselves in similar predicaments.

Mr. OXLEY. Yes, sir.

However, that factor is important, Senator, to help prevent monopoly, and I would like to make a statement in that regard.

The trend of the present law is definitely toward monopoly and the absorption of small, new companies by larger, older ones. The larger, older companies with substantial earnings records have substantial base periods and correspondingly substantial allowable excess-profits-tax credits. However, small, new companies are subject to tax at the maximum rates, lacking earnings records to give them adequate base periods, and are thus unable to retain sufficient earnings to reinvest and expand to meet the demands of their normal growth.

This leaves them at the mercy of larger, older competitors and makes the inevitable trend toward monopoly and the absorption of small, new companies by larger, older ones.

Gentlemen, I cannot bring myself to believe that Congress consciously intended any such result. I appreciate the opportunity you have given me to appear before you.

Senator MILLIKIN. Thank you very much for your testimony.

Mr. OXLEY. Thank you.

Senator MILLIKIN. In lieu of an appearance, we have a letter here from Ralph W. Heninger which will be inserted in the record.

(The letter referred to follows:)

BETTY, BETTY, NEUMAN, HENINGER & VAN DER KAMP,
Davenport, Iowa, July 23, 1951.

Hon. HARRY F. BYRD,
Acting Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: Thank you for your letter of July 19 in reference to my appearance before the Committee on Finance in reference to H. R. 4473 and particularly as to the excess profits tax relief.

I would like very much to appear before the committee. So far as I know it would not be possible to consolidate my proposed testimony with that of any of the listed witnesses for the reason that I am not acquainted with any of the witnesses and neither do I know the nature of their testimony.

My appearance would be particularly directed to the excess-profits-tax provisions which, because of the inequitable provisions of the present law and the proposed amendment, produce undue hardship on the small businesses of our community.

The fact is that it is the newer corporations often formed by veterans who fought in the last war and who are now trying to get started in business that bear the brunt of the excess-profits tax. The older corporations with certain historical records do not suffer too severely.

The particular provision which will strike hard against the small business enterprise is section 123 of the revenue bill as introduced in the House. This provision proposes to limit the surtax exemption and the excess-profits tax exemption to only one corporation where different corporations are related to one another. It is understood that the Treasury Department argues that the existence of separate corporations in a related group contributes to tax avoidance. This is not true in most instances. The formation of separate corporations, where based on a sound business purpose, presents the opportunity for the small-business man to conduct his business in accordance with the directives necessitated by developing economy. It is only by making every business stand on its own feet that working capital can be procured from banks and individuals, and only by allowing a minimum credit to each business can the business grow, purchase machinery and equipment, and provide a service to its community.

In my opinion, section 123 accomplishes no useful purpose and should be completely eliminated.

Furthermore, I regard the section as entirely unnecessary. The Bureau of Internal Revenue has already the power under section 45 to do the very thing which section 123 of the proposed law seeks to do. In other words, by allocation of income under section 45 the Bureau could throw the income into the principal corporation and tax it and thus eliminate the exemptions where avoidance takes place.

To adopt section 123 will only cumulate law upon law rather than make use of existing powers already in the law.

I would like to elaborate on this further before the committee, but if no opportunity is possible I will appreciate your presenting this thought at the time of executive session.

Yours very truly,

RALPH U. HENINGER.

Senator MILLIKIN. Mr. D. J. Renkert. Make yourself comfortable, Mr. Renkert.

STATEMENT OF D. J. RENKERT, PRESIDENT, METROPOLITAN BRICK, INC.

Mr. RENKERT. Thank you, Mr. Chairman.

My name is D. J. Renkert. I am president of Metropolitan Brick, Inc., of Canton, Ohio.

I suggest a minor amendment to section 435 (e) of the Internal Revenue Code having to do with average base period net income based on the growth formula.

This is somewhat of a relief provision and, in part, provides that if the total payroll of the taxpayer for the last half of the base period years 1948 and 1949 is 130 percent or more of its total payroll for the first half of its base period years 1946 and 1947, then the average base period net income shall be computed under section 435 (e) (2) of the code.

This provision in my opinion was inserted in the code to grant relief to those corporations which were expanding and where the earnings for all four of the base period years did not represent the normal operation.

From 1945 to 1950, inclusive, my company spent $1,154,500 in carrying out its policy of modernization and expansion. I should say here that this company is rather a small company. Its annual sales vary from five to six million dollars a year.

Based on the present language of the statute, our percentage is 119.7 percent and not 130 percent, as required by the code.

However, we are being penalized because of a temporary operation carried on at our Cleveland plant. At the close of World War II the

Government was demanding that all building materials be produced as rapidly as possible. Actually the Government granted subsidies in order to get plants such as this one I am now referring to into production.

In cooperation with this effort of the Government our Cleveland plant was placed in operation on a temporary basis and produced common brick, which was not a part of our regular line of products, from December 1944 to the end of June 1947.

The plant was then totally wrecked, and only the land remains. Our expansion has been very substantial since we have spent over a million dollars in capital improvements in the last 5 years, but by including the temporary Cleveland operation in our total payroll, our percentage of increase is 119.7 percent instead of 130 percent.

With the Cleveland plant operation eliminated, which was entirely temporary, our percentage would be 130 percent.

This technicality makes a difference of $100,000 in our excess-profits tax base. In all other respects we comply with the growth formula set forth in the code. This is not a large corporation and, I submit that this inequity should be eliminated.

I have a written statement which I would like to have made a part of the record, which statement includes a suggested amendment.

Senator KERR. It will be put in the record in full.

(The amendment referred to is as follows:)

SUGGESTED AMENDMENT TO SECTION 435 OF THE INTERNAL REVENUE CODE

Metropolitan Brick, Inc., of Canton, Ohio, suggests an amendment to section 435 of the Internal Revenue Code so that corporations operating a plant only for a temporary period during the first half of the base period will not be prohibited from having its average base period net income computed under the growth formula as stated in section 435 (e).

The company operated a plant in Cleveland, Ohio, and not being an efficient operation was closed down on December 24, 1942. The company had no intention of resuming operations.

During World War II there was no opportunity to dispose of a brick plant and since the company's other plants were forced to close down or operate on a restricted basis it was not advisable to assume the expense of wrecking the plant during the war period.

At the close of World War II there was an urgent demand for clay products. The Government was demanding, because of the housing shortage, that all building materials be produced as rapidly as possible. Manpower had been lost by the brick industry due to the draft and higher wages paid in the war industries. Necessary machinery was hard to obtain and repairs had to be made.

In order to better serve the construction industry and comply with the Government's request for immediate full production the Cleveland plant was placed in operation on a temporary basis. It produced common brick which was not a part of our regular line from December 1944 to the end of June 1947. The plant was totally wrecked, only the land remains.

The company at the close of World War II embarked on a policy of modernization and expansion for the plants it meant to keep in regular production. During the period from 1945 to 1950, inclusive, the company spent $1,154,499.18 in carrying out this program. The Cleveland plant was not included in the program.

The Government offered subsidies to the brick industry to get idle plants and marginal plants into production. The taxpayer now finds itself in the poor position of having tried to cooperate with a Government effort that went to the extent of paying subsidies and now being penalized to the extent of $30,000 per year in excess profits taxes.

Section 435 (e) of the Internal Revenue Code precludes a taxpayer from obtaining the benefits of the growth formula unless the total payroll of the taxpayer for the last half of its base period (years 1948 and 1949) is 130 percent or more of its total payroll for the first half of its base period (years 1946 and 1947).

The taxpayer's percentage is 119.7 percent; whereas if the temporary operation of the Cleveland plant is eliminated, the percentage would be 136 percent.

Cleveland plant

	Net sales	Payroll	Excess profits tax net income
1944	$38,865.40	$12,842.27	[1] $13,260.00
1945	56,229.16	23,190.93	[1] 17,921.00
1946	459,466.18	184,700.66	[2] 86,790.00
1947	158,572.81	123,097.96	[1] 20,761.00
1948 [3]	68,900.21	25,458.71	[1] 7,514.00
1949 [3]	0	1,867.72	0

[1] Loss.
[2] Gain.
[3] The Cleveland plant ceased manufacturing operations in June 1947. There were subsequent sales made from inventory after production stopped and the payroll item consists of shipping labor, maintenance, and clerical services.

Permanent plants

	Net sales	Payroll	Excess profits tax net income
1946	$1,763,402.[illegible]	$956,442.23	$280,868.25
1947	2,072,330.31	1,090,239.43	204,065.74
1948	2,895,435.86	[illegible]	452,691.99
1949	3,021,378.50	[illegible]	507,136.92

CONCLUSION

It is suggested that the definition of total payroll (section 453 (e) (4)) be amended by adding after the word "employees" in the fourth line thereof the words "excluding the amount thereof paid or incurred in connection with a temporary operation". This would eliminate payroll from an operation that was known from the beginning to be temporary. The growth formula should apply only to the regular business carried on by the taxpayer.

Mr. RENKERT. Thank you, sir.

Senator KERR. I was necessarily out of the room. Is your situation one comparable to the man just on here, that it has to do with the date of your organization?

Mr. RENKERT. No. Our company was organized in 1902.

Senator MILLIKIN. His problem arises out of the pulling down of a plant that was put into temporary operation.

Mr. RENKERT. We had a plant that was idle and scheduled for demolition prior to the war and during the war period we could not do it; and in response to the Government's plea we did put it into temporary operation in the first 2 years of the base period.

Senator MILLIKIN. Thank you very much.

Mr. RENKERT. Thank you, sir.

Senator MILLIKIN. Mr. Philip L. Corson.

STATEMENT OF PHILIP L. CORSON, PRESIDENT, G. & W. H. CORSON, INC.

Mr. CORSON. Mr. Chairman, and gentlemen of the committee, my name is Philip L. Corson. I am president of G. & W. H. Corson, Inc., of Plymouth Meeting, Pa.

We manufacture lime, refractories, and limestone products from our quarry located near Philadelphia, Pa.

As a businessman I believe I appreciate the tremendous problem confronting this committee in its effort to raise the necessary revenues for the national defense requirements, and we are perfectly willing to bear whatever taxation must be imposed to preserve our American way of life.

My testimony will be brief and will be directed mainly to the excess-profits-tax law and particularly to a provision which I believe was unintentionally discriminatory to the producers of vital nonmetallic minerals.

Steel is the basic sinew of war and to meet the needs of a rapidly expanding steel industry, the development and production of high-grade metallurgical limestone must be greatly stepped up and expanded. Steel cannot be manufactured without limestone. There is no substitute for this basic material.

For every ton of steel manufactured, nearly one-half ton of limestone is required, and I pause because that is seldom appreciated, the fact that it takes one-half ton of limestone to make a ton of steel—either in the form of raw limestone, burned limestone, or dead burned dolomitic limestone. The function of the limestone is to remove the silica and alumina by forming a slag, which floats off when the iron is run out of the furnace. Again, when the iron is converted into steel in the open hearth, large quantities of either limestone or lime, or both, are used to further purify the steel by the removal of most of the remaining silica and alumina.

In addition, the walls and bottoms of the open hearth are protected by dolomitic limestone in either a raw or dead burned form. For efficient operation steel manufacturers require a pure limestone. Great strides in raising production have been made by using the highest grade limestone, and we believe that the discovery, development, and use of pure limestone deposits must not be overlooked since it is vital to any increase in our steel production.

Senator MILLIKIN. Does your proposal go to only that type of limestone?

Mr. CORSON. Yes, sir.

The bill before you, H. R. 4473, provides percentage depletion at the rate of 15 percent for chemical and metallurgical limestone and I want first to urge the approval of this section by your committee to remove a long-standing inequity and encourage the production of this mineral.

In the 1950 Excess Profits Tax Act, Congress included section 453 which was intended to give incentive to producers of minerals by exempting from this tax a proportion of any profits made on production increases during the defense or war period.

However, most mineral producers have never received this incentive due to an added provision which requires that the increased production must exceed 5 percent of the units in the deposit at the end of the taxable year or no tax exemption is allowed. How almost completely this added provision nullifies the intent of the section is shown by the following example:

If a producer increases his normal output of 300,000 tons per year to 400,000 he will receive no relief unless at the end of the year his deposit contains less than 1,900,000 tons. At this rate of production, this is less than a 5-year supply. Furthermore, any producer who engages in prospecting and development and is fortunate enough to discover additional deposits actually may be penalized in that the added number of recoverable units may disqualify him from any relief whatsoever.

Coal mines, metal mines, natural gas, and timber properties have been allowed a provision that exempts at least 50 percent of the profit on increased production from the excess-profits tax without reference to the number of recoverable units. This special provision was carried over from the World War II excess profits tax law, where it was originally included in recognition of the fact that although these producers in general possessed large reserves of recoverable units, those reserves would become increasingly difficult to exploit as exhaustion progressed.

Exactly the same situation prevails in the metallurgical and chemical limestone industry. It is also true of other urgently needed minerals such as sulfur, potash, and others.

The nonmetallic mines are now really in a worse position than they were under World War II law, for under the old law, there was some possibility of relief under sections 721 and 722. Under the present law, the failure to grant relief to nonmetallic mines in subparagraph (b) (4) results in taxing the normal profit of new nonmetallic mines, a distinctly discriminatory treatment, not only between industries but also against new mines in the same industry.

Therefore, section 453 should be amended by broadening subparagraphs (b) (2) and (b) (4) to include all nonmetallic mines and thereby give them the same benefits as are now given to coal and metal mines.

Senator MILLIKIN. Thank you very much. We will recess and meet at 10 o'clock Monday morning.

The Chair inserts various letters and statements in lieu of personal appearances at this point.

(The material referred to is as follows:)

STATEMENT RELATIVE TO NECESSITY FOR EXCESS PROFITS TAX RELIEF FOR TAXPAYERS UNDERTAKING NEW PRODUCTS OR SERVICES AND ABANDONING SUCH DURING BASE PERIOD

At the close of World War II during the reconversion period a number of manufacturers were seeking new products to augment their existing lines. In many instances the purpose of securing the new product was to relieve the company from dependence upon the economic events affecting a single industry and to permit the company, by diversification of its products, to cushion itself against an earnings depression attributable solely to that industry. There are two basic situations which occurred in this search for new products. The first is the case of corporation A which found a successful product which greatly augmented its income after an initial development period. The second is the case of corporation B which attempted to develop a new product but found that the new product could not be produced or marketed successfully, and consequently abandoned it. All of the factors necessary under section 443, Internal Revenue Code, being present, corporation A may secure relief under that section. Corporation B is, however, denied any relief whatsoever.

An example will illustrate the inequity of this situation: Two calendar year corporations, A and B, which were engaged in materially different types of production, commenced business prior to the beginning of their respective base periods. Early in 1947 each corporation adopted an entirely new line of product suitable to its own type of operation while continuing its established lines upon a profitable basis. Each corporation sustained losses in 1947, attributable to furnishing its new product, and substantial, although somewhat smaller, losses in 1948. Corporation A continued to market its new product in 1949 and subsequent years, and by concentrating on the new line, as contrasted with its established lines, made substantial earnings in the excess profits taxable years. B corporation, however, on December 31, 1948, determined that further production of its new product would be unprofitable and abandoned that venture. It continued to concentrate on its established lines and made substantial earnings in the excess profits taxable years. This excess profits net income for the pertinent taxable years may be indicated as follows:

	Annual average excess profits net income without regard to new line of products		Annual average excess profits net income or loss attributable to new product		Annual average excess profits net income	
	A	B	A	B	A	B
1946	$60,000	$60,000			$60,000	$60,000
1947	65,000	65,000	($75,000)	($75,000)	(10,000)	(10,000)
1948	70,000	70,000	(50,000)	(50,000)	20,000	20,000
1949	80,000	85,000	10,000		90,000	85,000
1950	85,000	135,000	45,000		130,000	135,000
1951	95,000	195,000	75,000		170,000	195,000

NOTE.—Figures in parentheses denote loss.

It is obvious that the average base period net income of both corporation A and corporation B, since it is affected by the substantial losses incurred in furnishing a new line of products, is an inadequate standard of normal earnings. Thus, while the need for remedial action is apparent in both cases, only corporation A may expect to secure relief in the taxable years 1950 and 1951 under the present provisions of the Internal Revenue Code. Corporation B, although it has been successful in its continued emphasis on its established lines, secures no relief whatsoever, despite the resulting inequity of the use of an excess profits credit predicated upon its base period experience.

It is our understanding that the underlying theory of present section 443 (a), Internal Revenue Code, is to provide relief where a corporation has introduced new products in its base period, substantially as this concept of change of product was developed under the World War II law with the exception that certain objective standards have been added. Relief is provided for companies meeting the requirements of section 443 (a) (1), (2), and (3) since their base period excess profits tax net income is not deemed to be representative of their potential earnings level by reason of the development or initiation of a new product or products. If relief were not granted, a hardship would be worked upon them at a later time when such potential earnings are realized and subject to the excess-profits tax.

The exact same need for relief exists in the case of companies whose base period income was not representative of potential earnings because their earnings were adversely affected by losses incurred in starting new products or initiating new services and abandoning such new products or services when it was finally found to be impossible to produce them successfully. Certainly any attempt to determine the average base period net income in the latter situation, without giving due consideration to the fact that the income for the base period has been reduced by losses that bear no relation to the business operations of the excess-profits tax taxable years, is inequitable and unjustly penalizes such companies for exploring new fields of endeavor.

The primary objective of this statement is to point out the existing inadequacy of the Excess Profits Tax Act in respect to the class of taxpayers illustrated by corporation B above. There are undoubtedly several methods by which this inequity may be corrected. It is recognized that any correction must be accomplished with the maintenance of an objective standard of application as well as proper limitations to avoid breaking down the underlying purpose of the act. Without attempting to define how the correction should be accomplished, it is sufficient to mention two methods. One method is by an amendment to section 443, Internal Revenue Code, which would establish a standard as to abandonment of a line of products and provide the same relief now granted only to those adopting and continuing a new line of products or services. The other method could accomplish a similar result through the addition of a subsection to section 433 (b) (9), Internal Revenue Code, providing that losses from operation and abandonment of new ventures would qualify as an abnormal deduction in relation to base period net income.

It is, therefore, respectfully urged that some type of relief is necessary for taxpayers instituting and subsequently abandoning a new line of products during the base period years.

Respectfully submitted.

BAKER, HOSTETLER & PATTERSON,
By S. D. L. JACKSON, Jr.

RAYTHEON MANUFACTURING CO.,
Waltham 54, Mass., July 27, 1951.

Hon. WALTER F. GEORGE,
The United States Senate,
Washington, D. C.

DEAR SIR: As one of the larger suppliers of electronic equipment to the armed services, we wish to urge your support of section 482 of the House revenue bill of 1951. The purpose of this section is to exempt sales to the United States of radio communication, detection, and navigation receivers from the manufacturer's excise tax. Raytheon now has upwards of $100,000,000 in defense contracts and employs over 14,000 people.

We understand that both the Department of Defense and the Treasury support this provision because, as explained below, it will aid the defense effort at no cost, and in fact at a saving to the Government.

Much of the electronic equipment being purchased by the armed services contains radio receiving elements on which the Government imposes a 10 percent manufacturer's excise tax. The burden of this tax is borne by the armed services which purchase the equipment. (Standard Government contract clauses contain a statement that all applicable taxes are included in the price.) Payment of this tax needlessly inflates costs and, therefore, the size of appropriations necessary to purchase a given quantity of equipments. Nothing beneficial to the Government, the public or anyone else results from imposition of this tax on Government purchases. The money is taken from one pocket of the Government (the armed services) and put into another (the Treasury). Nor is this transfer from one pocket of the Government to the other accomplished without considerable cost to the Government and serious waste in the defense effort.

The useless passing of these tax dollars around from the military to the contractors to the Treasury wastes a serious amount of engineering and accounting effort at the contractors' level and also wastes effort in the armed services, as well as in the Treasury Department.

The wasted engineering effort on the part of the manufacturers stems from the fact that many electronic equipments supplied to the armed services are partly taxable and partly nontaxable. While there is a tax on radio receiving sets, no tax is imposed on radio transmitting equipment. The radio receiving set tax applies to the radio receiving portion of combination transmitting and receiving equipments, radio direction finders and other electronic equipment. The Bureau of Internal Revenue takes the position that the part of such equipment that cannot be separated out as clearly nonreceiver portion is subject to the tax. The tax is computed on that portion of the manufacturer's price attributable to the taxable portion.

Thus, in order to compute the tax for inclusion in his bid, the contractor must have engineers and cost estimators break out the nonreceiver parts of such equipments. We have found that it takes an engineer as much as a week's time to break out the nontaxable portion of one such contract and estimate the tax for the bid. With the supply of engineers so critical throughout the electronics industry that they are on a 48 hour basis, this is a serious interference with the defense effort. Not only is engineering time diverted from production, but also the cost of this wasted engineering must increase the contract cost borne by the armed services.

The administrative expense of this tax both for the contractors and the armed services will be further increased as the result of redetermination and renegotiation. The problem of determining what part of the contract price is subject to tax will be immeasurably increased as the result of over-all renegotiation of a contractor's fully taxable, nontaxable, and partially taxable contracts; the resulting mixups for their contractors will be wasteful and costly for the armed services.

Recent legislative precedent for the governmental exemption is to be found in section 706 of the Second Supplemental Appropriation Act, 1951 (H. R. 9920) which enacted a similar exemption from the tax on small arms and ammunition as follows:

"None of the firearms, pistols, revolvers, shells, and cartridges purchased with funds appropriated for the military department by this or any other act shall be subject to any tax imposed on the sale or transfer of such articles."

We understand that the Radio-Television Manufacturers' Association is supporting a broader bill which would exempt all sales of this type of equipment, commercial as well as governmental. While we have no objection to this bill, we must point out that, unlike section 482, it does deprive the Government of revenue.

Sincerely yours,

C. F. ADAMS.

THE AMERICAN LEGION,
NATIONAL LEGISLATIVE COMMISSION,
Washington, D. C., July 20, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Referring to H. R. 4473, same being a bill to provide revenue, I enclose copy of Resolution No. 101 adopted at the 1950 annual convention of the American Legion calling for the enactment of Federal legislation excluding all service pay received during wartime by noncommissioned personnel, and excluding up to $1,500 received by commissioned officers when computing their gross income for Federal income tax purposes for the year 1950 and up to the end of the current international emergency.

When the Senate Finance Committee takes H. R. 4473 under advisement, I respectfully request that consideration be given to incorporating therein a provision which would carry out the intent and purport of the attached resolution.

As you know, Senator McFarland recently introduced S. 1881, which calls for the elimination of compensation of members of the Armed Forces from their taxable income.

Thanking you for your courtesy in the matter, I am

Sincerely yours,

MILES D. KENNEDY, *Director.*

NONCOMMISSIONED MEN RECEIVE A $1,500 DEDUCTION FROM GROSS INCOME FOR FEDERAL INCOME TAX PURPOSES

Whereas the present Korean conflict with the United Nations has made it apparent that the United States must greatly enlarge its Armed Forces in order to defend itself from without and from within; and

Whereas an inducement must be given to many persons to enter the United States Armed Forces; and

Whereas the vast majority of those who will serve in the Armed Forces of the United States during the present emergency will receive appreciably less income than they would have received had they been allowed to follow their civilian pursuits: Now, therefore, be it

Resolved by the American Legion in convention assembled in Los Angeles, Calif., October 9–12, 1950, That we seek the enactment of a Federal law excluding all wartime active service pay for noncommissioned service and commissioned pay for active service to the extent of $1,500 from gross income for Federal income tax purposes for the year 1950 to the end of the present emergency for all Armed Forces personnel of the United States.

THE CLEVELAND CHAMBER OF COMMERCE,
Cleveland 14, Ohio, July 31, 1951.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: Enclosed is a copy of a report of the committee on Federal taxation of the Cleveland Chamber of Commerce dealing with H. R. 4473. It has been approved by the chamber's executive committee.

The committee believes that the tax rates proposed in the bill will discourage incentive, deter investment in business and encourage the very inflation that we are supposed to be attempting to combat. We are not convinced that taxes must be raised at this time in order to balance the budget for the 1952 fiscal year. If additional taxes are really needed for indispensable purposes we believe that they should be raised by a uniform excise tax levied at either the manufacturer's or retail level on all products except liquor, tobacco, and food, and by taxing presently tax-exempt organizations that compete with private business.

We favor the recognition of gain on the sale of a residence, exempting from corporate income tax venture capital companies, treating as deferred expenses development expenses of mines.

We oppose a withholding tax on dividends, interest, and royalties.

It is our opinion that with the exception of a few provisions the bill should be discarded and that the Senate Finance Committee should present a new bill.

Your consideration of our recommendations will be sincerely appreciated.

Sincerely yours,

CURTIS SMITH,
Executive Vice President.

REPORT ON THE PROPOSED REVENUE ACT OF 1951

To the Executive Committee of The Cleveland Chamber of Commerce

GENTLEMEN: Your committee has given consideration to H. R. 4473, known as the Revenue Act of 1951, recently passed by the House of Representatives and now being considered by the Senate Finance Committee.

It is the opinion of your committee that a more ill-advised tax bill has never before been reviewed by it. The bill would take from 52 to 70 percent of corporate income for taxes, with certain portions of such income taxable at as much as 82 percent. Individuals would pay taxes varying from 22⅛ to 94½ percent of taxable income with a maximum take equal to 90 percent of an individual's taxable income. Is it any wonder that the movement now underway to adopt a constitutional amendment limiting income taxes to a maximum of 25 percent gains ground every day? Ill-conceived as such a movement may be, taxpayers in desperation may figure it is the only way of stopping the constant round of spending and spending, taxing and taxing.

Tax rates such as proposed in the Revenue Act of 1951 discourage incentive, deter investments in business and encourage waste which stimulates the very inflation we are supposed to be attempting to combat. Corporations, being operated by human beings with human failings, are bound to spend money wastefully and extravagantly when 82 percent of the dollars they are spending would go for taxes if not spent. This naturally stimulates inflation. An individual with large income will not invest in business if 94½ percent of his income from business investments is taken away from him. He can secure more than five times as much retainable income for himself by investing in 2 percent nontaxable municipal bonds than he would secure under the proposed tax law from investments in corporate stocks yielding 7 percent. Obviously, business will lose the investment of his funds. When from 22⅛ to 94½ percent of an individual's net taxable income is taken for taxes, certainly incentive is dealt a blow, for the rewards for hard work will go mainly to the tax collector. The tax rates proposed in H. R. 4473 will surely strangle the goose that lays the golden tax egg, will eventually result in less rather than more taxes being realized, and should not be enacted except in the direst kind of emergency.

Your committee is not at all convinced that taxes must be raised at this time in order to balance the budget for the 1952 fiscal year. Budget expenditures for fiscal 1952 are estimated at approximately $68 billion, and authoritative estimates indicate that revenues under existing tax laws might well aggregate $62 billion to $63 billion. No one yet knows the full amount of revenue that will be derived as the result of the passage of the Revenue Act of 1950 and the Excess Profits Tax Act of 1950. This will be the first year in which the full burden of those acts will start to be felt. It would appear to be a reasonable certainty that considerably more revenue will be realized in fiscal 1952 than Treasury officials have admitted. If Congress would reduce unnecessary expenditures by as little as $5 billion, the chances are excellent that the budget would be balanced for fiscal 1952 without imposing upon the country's economy a third revenue-raising act within the space of one year.

Congress must face up to its responsibilities at some time and reduce nonessential spending. This committee has stated time and again and now reiterates that economy is the big responsibility of every Member of Congress. Waste and extravagance cannot be tolerated in any department of the Government, barring none. Specific recommendations for cuts in expenditures have been made to Congress on numerous occasions and by numerous organizations. Practically none of these have been placed in effect. We believe that the time has come for Congress to concentrate all of its energies on elimination of nonessential spending and reduction of less-essential spending. When that has been done, your committee believes that it can then be determined what, if any, additional taxes are really needed to cover absolutely essential costs.

H. R. 4473 proposes to raise $7.2 billion of new revenues, of which $2.8 billion would come from individuals, $2.8 billion from corporations, $1.2 billion from excise taxes, and the balance from changes in various provisions of existing revenue laws. If new revenues are needed to balance the budget, after Congress has done a real job of cutting nonessential expenditures, these new revenues should not come from increases in corporate or individual tax rates. As pointed out earlier in this report, excessive tax rates, reaching almost the point of complete confiscation, injure the economy of the country when it should be made strong, drive investment funds out of productive business investments and into nonproductive nontaxable securities, are inflationary in nature because of the waste they encourage, and may well result in less rather than more revenues by stifling individual and corporate incentive. We are therefore opposed to the proposed increases in corporate and individual tax rates. For the same reasons we oppose (1) reducing the percentage of average base-period net income used in determining the excess-profit tax credit, (2) increasing the ceiling on the amount of corporate income that may be taken by corporate and excess-profits tax rates, and (3) restricting corporations in a "controlled group" to one minimum excess-profits tax credit and one surtax exemption. (The alleged loophole to be closed by (3) can be closed under sections 45 and 129 of the present Internal Revenue Code.)

If additional taxes are really needed for indispensable purposes, this committee has previously recommended that they be raised by a uniform excise tax levied at either the manufacturer's or retail level on all products except liquor, tobacco, and food and by taxing presently tax-exempt organizations that compete with private business. Liquor and tobacco should be continued subject to excise taxes at higher rates than the proposed uniform tax.

If higher taxes are needed to arm and protect this country, then everybody receiving the benefits of that protection should share some portion of the cost thereof. There are still millions of people in this country who pay no income taxes, and there are still cooperatives and other nontaxable organizations that pay no income taxes even though they conduct large income-producing businesses in competition with taxable corporations. Congress must certainly consider whether these people and organizations are to continue tax-exempt even when the President asks for more revenues than were raised during World War II.

If one of the purposes of a new tax bill is to combat inflation, then certainly a uniform excise tax will accomplish this purpose better than any other type of tax. High income and excess-profits tax rates encourate spending, but excise taxes reduce the amount of money available for spending in relation to the amount of goods available. In times like these, therefore, an excise tax accomplishes the twofold purpose of being anti-inflationary and at the same time raising needed revenues.

Certain provisions of H. R. 4473, other than those dealing with increased tax rates, should also be dealt with in this report.

A few of these provisions should definitely be enacted in any new revenue act. These are:

1. The recognition of gain on the sale of a residence only to the extent that the proceeds exceed the cost of a new residence purchased within 1 year before or after the sale of the old residence. This takes care of a long-needed change in the tax treatment of this type of transaction.

2. Exempting from corporate income-tax venture capital companies which supply capital to corporations engaged principally in developing or exploiting new inventions, processes, or products where such companies distribute substantially all their income, including capital gains, to their stockholders. This provision properly places venture-capital companies in the same tax category as regulated investment companies.

3. Treating as deferred expenses development expenses of mines, after discovery of commercial quantities, and permitting deduction thereof ratably over the period during which the mineral is sold. This should stimulate the discovery and development of additional mineral facilities and provides for the proper method of deducting development expenditures.

4. Recognition as a true partner in family partnerships of a person owning a capital interest in a partnership in which capital is a material income-producing factor whether or not such interest is derived by purchase or gift. This provision should have been part of the income-tax law for many years, and Congress might well consider making the provision retroactive.

One provision of H. R. 4473 to which your committee is strongly opposed is the provision for a withholding tax of 20 percent on dividends, interest, and royalties. Congress was asked in 1950 to pass such a law in a particularly objectionable form and refused to do so. The proposed type of withholding, while not quite so objectionable, nevertheless has many serious defects. The proposal is for a gross withholding without any exemptions and without any report to the Treasury as to the person from whom the tax was withheld or to the stockholder whose dividend was diminished thereby. It would be necessary to every stockholder who actually owed no tax to file a claim for refund. In the meantime the Government would keep his money, and if he failed to file a refund claim through oversight or lack of knowledge he would lose 20 percent of his dividend. Tax-exempt charities would be deprived of 20 percent of their dividend income until refund claims were allowed. Since such claims would have to be filed every year, the practical effect would be to more or less permanently deprive them of that portion of their dividend income. Corporations owning stocks of other corporations are taxed only upon 15 percent of the dividends they receive. If 20 percent of their dividends were withheld, the amount withheld would amount to well over 150 percent of any tax they could conceivably owe on dividends received. The foregoing are just a few examples of the many defects in the proposed withholding plan. It should not become law.

The net result of your committee's consideration of H. R. 4473 is that, with the exception of a few provisions thereof, the bill should be discarded and that the Senate Finance Committee should present a new revenue bill, if any is actually needed after Congress has done a real job of pruning wasteful and unnecessary expenses.

Respectfully submitted.

COMMITTEE ON FEDERAL TAXATION,
E. G. HALTER, *Chairman.*

JULY 27, 1951.

WASHINGTON, D. C., *August 1, 1951.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.:

Statements of some retail organizations to effect that they would accept retail sales tax in lieu of manufacturer's excise tax being widely misinterpreted to indicate that retailers favor sales taxes. As national organization representing men's-wear merchants, we do not see the need for either tax. Thousands of retailers, particularly small merchants in communities where there is city and State sales taxes, bitterly opposed to retail sales tax under any circumstances and we urge their views before your committee. Please see that this message of clarification and opposition to retail sales tax is brought to the attention of your committee.

LOUIS ROTHSCHILD,
Executive Director, National Association of Retail Clothiers and Furnishers.

THE GREYHOUND CORP.,
Chicago, Ill., July 23, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SIR: Your committee is currently considering the revenue bill of 1951 as contained in H. R. 4473. Section 123 of this bill provides that corporations that are members of a controlled group will be entitled to only one surtax exemption of $25,000 and only one minimum excess-profits credit of $25,000 for the group, instead of a surtax exemption and minimum credit of $25,000 for each corporation, as under the present law. This revision imposes an unwarranted penalty in cases where it is necessary for good and valid business reasons to maintain a number of corporate entities in a related group. The effect is to reduce a controlled group to a single corporation for tax purposes, and if this has to be done it would seem only equitable that the law should also be changed to permit the filing of consolidated returns without penalty.

Section 201 of the bill, which provides for withholding of income tax at source on dividends and interest, is also extremely undesirable, as it will result in a considerable increase in accounting and administration work. It is grossly unfair to require corporate taxpayers, already burdened with the responsibilities as well as the costs of acting as tax-collecting agents for the Government, to assume the additional work and expense of withholding income taxes from dividend and interest payments. If this method of collecting taxes is the most desirable one from an economic standpoint, the corporate-tax collectors should at least be reimbursed for all costs and expenses attributable to the task.

The bill on the whole provides for substantial increases in tax rates which we feel are unreasonable, unwarranted, and, in some cases, discriminatory.

We respectfully request that our views concerning sections 123 and 201 of H. R. 4473 be incorporated in the record of hearings now in progress before your committee.

Respectfully yours,

A. P. SLEDZ,
Vice President and Comptroller.

INKOGRAPH CO., INC.,
New York, N. Y., July 27, 1951.

Hon. WALTER F. GEORGE,
Senate Office Building,
Washington, D. C.

DEAR SENATOR: This letter is being written in order to bring to your attention the inequities that will occur should the Senate Finance Committee adopt that portion of tax bill which intends to place a manufacturer's excise tax on low-priced fountain pens.

No doubt the following facts have been called to your attention, and it is my desire merely to reiterate them and to stress the importance of these objections to the tax.

Statistics show that there are approximately 30,000,000 students in this country who use fountain pens, the same being a very important item to them in their school work.

It is also known that these students do not usually purchase such pens which are now subject to sales tax, because of the item being classified in the jewelry line; but they do purchase the lower-price pens, especially children who attend the elementary and high schools. In most cases, they would buy a pen which would cost them either $1 or $2. These children do not have any money of their own, but must obtain the price for these pens from their parents.

The manufacturer's tax of 20 percent would immediately make these children pay $2.40 for a $2 pen and $1.20 for the $1 pen. I do not believe it is the desire of your committee to burden these children or their parents with any additional costs for an item which is so essential to their daily needs.

Statistics also indicate that fountain pens are in considerable use amongst the military and governmental agencies. The soldiers in campaigns and in fields write letters to their parents, friends, and those close to them, using fountain pens. I do not believe it is the desire of your committee to compel these soldiers to pay more for a fountain pen which is needed by them.

Some time ago, the Government sponsored a letter-writing campaign asking American citizens to write to friends in foreign countries with the purpose of creating good will between our people and those of these other countries, all this writing to be done with fountain pens. We do not believe that the Government would want to make these people pay more for a writing instrument, especially when it is hoped that this letter writing will accomplish the purpose for which it was intended.

In conclusion, may I take the privilege of asking you to use your good offices toward eliminating this hardship tax, this manufacturer's excise tax, which would create such hardship on people who can least absorb additional expenses at the present time.

We have not written to any other members of your committee, and, therefore, would appreciate that these facts be called to their attention by you.

Respectfully yours,

A. L. KIEBEL, *Vice President.*

MEMORANDUM SUBMITTED BY MILES PENNYBACKER, PRESIDENT, NEW COUNCIL OF AMERICAN BUSINESS

When big business representatives plug for higher taxes, it's about time somebody began to look under the chips. The New Council of American Business is accustomed to looking under the chips, particularly under the blue chips. And we are not necessarily wrong in questioning their motives or their theories on taxes at this time just because a lot of Government, labor, farmer, consumer, and small business representatives have hopped on the band wagon with shouts of "balance the budget."

We suspect that big business is interested primarily in the removal of price and other direct controls. Naturally they are not averse to higher taxes on consumers if this can be used as an excuse for reducing direct controls.

No doubt others are sincere in their belief that the proposed new taxes will act as a brake against inflation. We question whether the additional taxes thus far proposed will act as such a brake. Here are our reasons:

1. The proposed increases in tax rates on individual income are too small to affect the price level. If we wanted to keep the price level down, we would have to increase taxes by such an enormous amount that the standard of living would drop to dangerous levels.

The President called for $4 billion a year increase in revenue from individual income taxes. The House bill provided for $2.8 billion increase in personal income taxes. Even the larger figure of $4 billion represents only little more than 1 percent of the gross national product (the total amount of goods and services supplied) and less than 2 percent of the total personal income. It is clear that, although the tax increase may be harsh for many individuals, from the over-all standpoint it can have only a minor effect on the general price level. This is especially true for the prices of all durable goods, and for most military supplies, where the inflationary trends are sure to be most pronounced.

Remember that not all of the money paid out in taxes will be a reduction in purchasing power and therefore an aid in the fight against inflation. The middle-income and upper-income people will reduce their savings, not their purchasing power, to pay these higher taxes. The lower-income people will have to cut down their buying to pay higher taxes; however, they will be reducing their purchases of items such as food and clothing, of which there is ample supply. (Look at what is happening these days in the textile, shoe, and other soft-goods lines.)

2. The contemplated increase in corporate income taxes will not materially affect business demand for plant and equipment and therefore will not reduce the pressure of demand for building materials and machinery. The corporations that do most of the business investing in this country have access to sources of funds; they don't rely on current income for business buying purposes. In addition, higher corporate taxes will stimulate higher prices, since in many lines of business the corporations will find it feasible to pass these higher tax payments on to the consumer.

To balance the budget temporarily may seem important. But it is more important to balance the budget, and retire the debt, over the longer period, say the next 10 to 20 years. If by blindly sticking to a budget-balancing policy today we contribute to a period of low incomes, low sales, and low profits in the near future we will not be helping the goal of a balanced budget over the longer term. This long-term goal can be achieved only by steps which will help to stabilize the economy when the rate of spending for armament is diminished.

A substantial rise in tax rates will reduce consumer savings, the savings we have to rely on for the purchase of homes, autos, and the like after the present emergency is over. New tax rates that destroy the consumer purchasing power after the present emergency—when we will have available the tremendous capacity now being built—will only lead to future budget deficits. Future budget deficits arising from depressed markets will—if we can judge from past experience—be larger and last longer than the contemplated deficit in the present emergency. On the other hand, a prolonged prosperity after the current emergency can be expected to produce many years of budget surpluses. Hence, balancing the budget today may not be the answer to an average balanced budget over the longer period ahead.

It is important to remember that Federal deficits are not synonymous with inflation. During the 1920's we had years of budget surpluses while in the depression we had deficits (not only during pump-priming years). Look at the more recent experience:

[In billions of dollars]

Calendar year	Federal cash receipts	Federal cash expenditures	Difference
1947	$44.3	$38.6	[1] 5.7
1948	44.9	36.9	[1] 8.0
1949	41.3	42.9	[2] 1.6

[1] Surplus.
[2] Deficit.

In 1948—a good business year—the Federal Government had an $8 billion cash surplus. In 1949, when production, sales, and profits were falling, there was over a billion dollars of Federal deficit. In the fiscal year just ended, a period of marked inflationary trends, we had a substantial surplus.

These figures show the shallow reasoning of those fiscal experts who intimate that the problem of inflation can be reduced to a mere problem of Federal deficits.

Inflation is a matter of over-all supply and demand. The theory behind increased taxes is that it reduces purchasing power and hence brings supply and demand into better balance. However, if taxes are to be an effective weapon to reduce demand, the rates will have to be much harsher than currently contemplated. And if they become harsh enough to reduce the inflationary danger, they will play havoc with the economy.

This is not to say that inflation is not a danger. It is a real danger. So much so, in our opinion, that we are willing to face the need for direct and effective controls on prices, on wages, and on materials. Let's not kid ourselves that loading more taxes on the low- and middle-income groups is the way to stop inflation. It will do nothing more than lower their standard of living, reduce their savings, and make the next recession more acute.

HECLA MINING CO.,
Wallace, Idaho, July 24, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: We request that your committee give careful consideration to the following comments pertaining to present and proposed tax legislation affecting the metal-mining industry. Although our remarks are generally applicable to the metal-mining industry throughout the United States, our discussion is more or less confined to the effect of present and proposed tax legislation on metal mining in the Northwest States, where the deposits are usually deep-seated, and prospecting and exploration, prior to discovery, requires substantial cash outlays.

As comptroller and secretary-treasurer of the Hecla Mining Co. and consulting partner in the firm of Randall & Magnuson, certified public accountants, of Wallace, Idaho, I am familiar with the tax problems of the mining industry in Idaho. Our firm either prepares or supervises the preparation of a majority of the tax returns for mining companies in the Coeur d'Alene district, a very important producer of zinc, lead, and silver.

According to the 1950 annual yearbook published by the American Bureau of Metal Statistics, the State of Idaho lead all of the States in the production of zinc and silver, and was second in the production of lead. A comparison of Idaho production with total United States production is set forth as follows:

	Zinc	Lead	Silver
	Tons	*Tons*	*Ounces*
Total United States production	618,207	429,875	34,944,554
Total Idaho production	87,875	102,500	9,921,891
Percent of Idaho production to total	14.2	23.8	28.4

Ninety-five percent of the total production of metals in the State of Idaho is produced in the Coeur d'Alene mining district located in the panhandle of Idaho in the area immediately surrounding Wallace and Kellogg, Idaho.

Prospecting and exploration necessary for discovery of new ores bodies in the Coeur d'Alene district require heavy cash outlays, since the ore bodies occur at depth. It is not at all unusual to discover ore at a depth of from 2,000 to 3,000 feet below the surface. This, of course, requires huge expenditures for exploration through shaft sinking and lateral crosscuts, the expenditures for which, under present tax law, are not deductible as an ordinary, expense. The only possibility of recovery of these expenditures in event of failure to find commercial ore is through abandonment which, of course, seldom occurs, since management is reluctant to abandon properties upon which perhaps a million dollars or more of the stockholders money has been expended. There is always a possibility that additional exploration may encounter profitable ore bodies.

Our present tax laws must be amended promptly if we are to attract risk capital into prospecting and exploration ventures. Otherwise there will be very few new ore bodies discovered to replace known deposits being rapidly exhausted through accelerated production. Government officials recognized that the present emergency demands that something be done immediately to encourage the discovery of new mineral deposits, and yet many seem to oppose a very simple solution set forth as follows:

AMEND OUR PRESENT TAX LAWS TO PERMIT THE EXPENSING OF EXPENDITURES FOR PROSPECTING, EXPLORATION, AND DEVELOPMENT INCURRED PRIOR TO DISCOVERY

The right to expense prospecting and exploration costs before discovery would obviously be an inducement, under present high tax rates, for individuals and corporations to risk capital in the search for metals, provided such expenditures were deductible for tax purposes in the year in which incurred. Excessive tax rates, under the present tax law, do not leave either the corporation or the individual sufficient earnings after taxes to carry on the necessary prospecting and exploration required to discover new deposits. Certainly I cannot see how there can be any loss of revenue over the long pull. In fact, the discovery of new profitable deposits will mean added tax revenue. Our Government has embarked upon a policy of loaning or matching funds as an inducement. However, the industry in general frowns upon assistance from Government as a subsidy and would much prefer a deduction for tax purposes. Under the present law, even major companies with huge surpluses are reluctant to speculate with funds for exploration. Many small corporations presently unable to finance exploration and development of their own properties would be in a position to attract capital from larger corporations through leasing arrangements.

In order to accomplish the above, I urge that your committee act promptly upon the following recommendations:

Amend the present tax law to permit the expensing of expenditures for prospecting, exploration, and development incurred prior to the productive stage of the mine by adding the following new paragraph (D) at the end of section 23 (a) (1) of the Internal Revenue Code as a substitute for the first nine lines of paragraph (D) of section 302 (a) of the Revenue Act of 1951 (H. R. 4473), which is now under consideration by your committee:

"(D) In the case of mines and other natural deposits (except oil and gas wells) all expenditures (in excess of net receipts from any minerals produced before the mine has reached the production stage) incurred in prospecting, exploration, and development may be deducted as expense, either in the year incurred, or at the election of the taxpayer, deferred and ratably apportioned to the production directly related to such expenditures, and to the extent not previously so deducted by the taxpayer may be deducted in the year in which it is determined that there is no reasonable expectation of such production thereafter."

Other provisions of section 302 dealing with adjustment of the basis, depreciable property, etc., could then be incorporated into the above. Section 302 (c) must necessarily then refer to page 75, line 24, as to "prospecting, exploration, and development" instead of merely to "development."

I fully realize that some officials in the Treasury Department will contend that percentage depletion compensates for expenditures incurred in prospecting and exploration and will therefore oppose the above amendment. However, the facts do not bear out their contention. Statistics gathered by the Idaho Mining

Association for years 1930 through 1940, inclusive, reveal that total expenditures by the mining industry in Idaho during this period aggregated $220,000,000, as compared to total receipts from sales of ore amounting to $210,000,000. In other words, the mining industry in Idaho during this period expended $10,000,000 more for prospecting, exploration, development, and mining costs, taxes, construction, etc. (exclusive of depreciation and depletion), than was realized in the form of receipts from the sale of ore. We have no statistics subsequent to 1940. However, if expenditures for prospecting and exploration had not been made during the above period, we probably would have very little production in the State of Idaho at the present time.

SECTION 302 OF THE 1951 REVENUE BILL (H. R. 4473)

As stated previously, I firmly feel that section 302 (a) should be amended as suggested above to permit the expensing of prospecting, exploration, and development incurred prior to the discovery of ore. Section 302 of the 1951 revenue bill is unquestionably a step in the right direction, since it solves part of the problem in permitting a deduction for development expenditures subsequent to discovery and prior to the productive stage, which, under present law, must be capitalized and is recoverable only through depletion.

However, I have one or two criticisms of the proposed amendment. While such development expenditures may be expensed as a deferred operating cost, the amendment would require that the expense be allocated over the ores benefited through such expenditure as the units of produced ores or minerals benefited are sold. In the Coeur d'Alene district, I believe that this wording may actually curtail development of presently known ore bodies. Management will be very reluctant to expend advance funds for development if such funds cannot be expensed in the year of expenditure, for the reason that the future year in which an expense deduction may be taken might be a loss year in which no tax benefit will be derived.

It has been our policy, which has apparently met with Bureau approval, to expense what is commonly termed "normal development." This includes development between levels such as for skip pockets and crosscuts from the shaft and also shaft extensions in cases where such extensions merely maintain output.

We believe line 24, on page 74, pertaining to the above section, should be amended by inserting after the word "sold" the following: "or at the taxpayer's election in the year paid or incurred." If the taxpayer wishes to expense his entire development costs, I cannot see why there should be any objection, since, in any event, he gets the deduction only once.

We believe that the following sentence should be added to the end of paragraph (D):

"Expenditures to maintain production of an operating mine shall not be considered as expenditures for development within the meaning of this paragraph but shall be deductible as ordinary costs of operation in the year such expenditure are made."

One other amendment which we believe should be made to section 302 deals with receipts from minerals produced before the mine has reached the productive stage. Section 302 makes no provision and we believe the following wording should be added after our proposed amendment insofar as development prior to the productive stage is concerned:

"Before the mine has reached the productive stage, net receipts from any minerals produced shall be applied to reduce any then remaining balance of expenditures."

After making the above amendments, sec. 302(a) of the Revenue Act of 1951 will read as follows (proposed amendments underlined):

"SEC. 302. EXPENDITURES IN THE DEVELOPMENT OF MINES

SEC. 302 (a). DEDUCTION OF EXPENDITURES.—Section 23 (a) (1) (relating to deductions from gross income) is hereby amended by adding at the end thereof, the following new subparagraph:

"(D) Development of mines: Expenditures paid or incurred after December 31, 1950, in the development of a mine or other natural deposit (other than an oil or gas well), to the extent paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed, shall be deductible, on a ratable basis, as the units of produced ores or minerals benefited by such expenditures are sold *or at the taxpayer's election in the year paid or incurred. Before the mine has reached the productive stage the net receipts from any minerals produced shall be applied to reduce any then* *remaining balance of development expenditures. To the extent that such expenditures have not previously been so deducted by the taxpayer, they may be deducted in the year in which it is determined that there is no reasonable expectation of such productive stage.* Such expenditures, and the adjustments to basis provided in section 113 (b) (1) (J), shall not be taken into account in determining the adjusted basis of the property for the purpose of computing depletion under section 114. This subparagraph shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 23 (l). For purposes of this subparagraph, allowances for depreciation shall be considered as expenditures. *Expenditures to maintain production of an operating mine shall not be considered as expenditures for development within the meaning of this paragraph but shall be deductible as ordinary costs of operation in the year such expenditures are made.*"

As stated previously, the proposed italicized amendments to section 302 above relate to expenditures for development incurred after discovery of ore in commercially marketable quantities. Of course section 302 does not take care of expenditures for prospecting and exploration incurred prior to the discovery of commercially marketable ore, and for that reason, we must again emphasize the necessity of making provision for a tax deduction for such expenditures, as suggested.

There are a number of other objectionable features to the Revenue Act of 1951 which warrant your consideration. For example, the proposal to reduce the present excess-profits-tax credit based on income from 85 to 75 percent is not justified. In fact, any reduction below 100 percent results in application of an excess-profits-tax rate to a portion of normal income which is obviously unfair. We urge that the present 85-percent allowance be increased to 100 percent.

The new bill also proposes that combined normal and surtaxes be increased to 52 percent. We believe the present 47-percent rate is excessive, especially when you consider that corporate income is now being taxed to the corporation and the portion retained after taxes by the corporation is taxed once more when distributed to the shareholders as a dividend.

Code section 131 (f) which grants a foreign tax credit only in the case of a majority owned foreign subsidiary is grossly unfair to the domestic corporation owning a minority interest in a foreign subsidiary. The ownership requirements should be reduced to a figure not in excess of 10 percent.

We urge that your committee give our comments careful consideration. We sincerely believe that the national emergency demands that our tax laws be amended in a manner similar to that set forth above in order to provide metals so necessary for the national safety.

Yours very truly,

HECLA MINING CO.,
L. J. RANDALL, *Comptroller.*

BAKER, BOTTS, ANDREWS & PARISH,
Houston, July 27, 1951.

Family partnerships, Revenue Act of 1951.

Mr. COLIN F. STAM,
Chief of Staff,
New House Office Building, Washington, D. C.

DEAR MR. STAM: As I have written you heretofore in reference to the treatment of family partnerships in the Revenue Acts of 1950 and 1951, I am writing in reference to the same subject as dealt with in section 313 of the revenue bill of 1951 as passed by the House.

In substance, in my opinion section 222 as contained in the revenue bill of 1950 as passed by the Senate is far simpler, clearer, and better all around than this section 313, and will make for far less litigation and at the same time will, as I have heretofore written you, be entirely fair to the Government. I would prefer section 222 as originally written, although I will suggest later in this letter a small change in one sentence.

SECTION 313 OF REVENUE BILL OF 1951

I appreciate very much your extended efforts to clear up this family-partnership muddle and the work that has gone into the preparation of section 313. However, from over 30 years' experience in tax matters and from a study of section 313 and many discussions of it with other lawyers and accountants, I believe we will have another flock of litigation over the meaning of certain provisions of section 313. I will discuss at the first certain technical objections and then take up the more fundamental ones:

1. The first sentence of section 191 as enacted by section 313 provides for the distribution of earnings in accordance with the partnership agreement and then makes an exception to the extent that the portion attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The third sentence then provides that an interest purchased by one member of a family from another shall be considered to be created by gift and the fair market value of the purchased interest shall be considered to be donated capital.

You will note that the provision of fair market value is technically limited to a purchased interest and the fair-market-value provision does not in so many words apply to a donated interest. It was probably your intention to have the fair market value apply both to a donated interest and a purchased interest but there is this hiatus in the language. With this hiatus, there is no measure provided for determining what is the capital represented by an interest donated by a parent to a child. However, for the balance of this letter I will assume that the fair-market-value provision applies both to donated interest and purchased interest.

2. There is no provision in the section by which the amount of the donor's capital is to be determined. I can see all through this many difficulties with revenue agents, and it is with revenue agents that all tax cases originate. I can see now long and extended discussions as to what the donor's capital is in a partnership and what the fair market value of a child's donated or purchased interest is. This becomes particularly difficult where there is a partnership of long standing. For example, I have now up with the Government a partnership created on December 31, 1935, between three brothers, two wives, and 10 trusts. Each year there will come up the question of what the capital of the three brothers and their two wives amounted to on December 31, 1935, and the fair market value of the interests given those trusts on that day. As of what date is the donor's capital to be determined? As of what date is the fair market value of a donated or purchased interest to be determined? In this connection, if a partnership has increased in worth at the time an interest is sold or given to children, then the fair market value of the children's interest would be worth more than the amount of capital originally put into the partnership by the parent and in such case the interest of the children would be recognized in full. In other cases a partnership will not have as much assets as it had originally, either by distributions or losses. In such case the fair market value of the interest acquired by children will be less than the proportionate capital originally put in by the parent, and in that instance the interest of the children will not be recognized in full. I do not think that this result was intended.

3. Section 313 as now written will apply no matter how old the donee or purchaser of an interest may be. It applies to all dealings between spouses, ancestors, and lineal descendants and any trusts for such persons. A man is in a partnership with two others, and has two sons that are up in their forties. He wants them to come into the partnership to take his place gradually. He therefore sells them an interest. Here again we have all of the intricate questions of the donor's capital and the donated capital when if section 313 is not enacted these two grown men who happen to be sons of a partner would be readily admitted by the Government as bona fide partners.

There may be an answer to the foregoing questions, but, if section 313 is passed, I do not know what answers I could give to a revenue agent if he raised them in the examination of one of these family partnerships.

SECTION 222 OF REVENUE BILL OF 1950 PASSED BY SENATE

As I have heretofore written you, I think section 222 is fair to the Government and fair to the taxpayer, and it does not have the complicated questions that arise under section 313, or at least arise in my mind and that of others. I think section 222 can go far toward eliminating a great deal of needless litigation.

In connection with section 191 as proposed to be enacted by section 222, I would like to call your attention to the second sentence as now written which reads: "If it does not so reflect the proportionate value of services, a reasonable proportionate allowance for such services shall be attributed to the partners rendering such service."

If I may do so, I would suggest that this sentence be changed to read: "If it does not so reflect the proportionate value of services, a reasonable amount for such services shall be attributed to the partners rendering such services before the determination of the partnership income allocable to the partners according to the terms of the partnership agreement."

The only change of substance that this would make would be to change the words "a reasonable proportionate allowance" to "a reasonable amount." I can see difficulty in the words "a reasonable proportionate allowance." I think it was intended that there should be a definite monetary allowance to the partner rendering the service, but under the present words it seems to me that there would be allocated to such partner a percentage of the earnings which might vary very considerably from year to year. If this is changed as I suggest to "a reasonable amount," this would mean a definite amount in dollars that would represent reasonable compensation for the partner's services, and I do not doubt but that in practically all cases taxpayers and the Government agents could come to an agreement as to what would be a reasonable "salary" in dollars whereas they might have a great deal of difficulty in agreeing upon an additional percentage of earnings.

RETROACTIVE FEATURE

I think that any provision in the Revenue Act of 1951 should be made retroactive to January 1, 1939, just like the Senate provided in section 222. If this change is made applicable only from the passage of the Revenue Act of 1950, it will be years before it will have any actual effect in cleaning up tax cases. On the other hand, making it retroactive to 1939 will make it applicable to present pending cases and establish a definite rule by which those family partnerships can be measured and bring to a ready conclusion practically all of the pending cases, either in favor of the Government or the taxpayers.

As the revenue bill of 1951 is now pending before the Senate Finance Committee, I am sending a copy of this letter to Senator George and to Senator Connally.

I have through these many years recognized the great value of your services and those of your staff to both the House and Senate in preparing the various revenue bills, and as a citizen I want to express my gratitude to you.

Yours very sincerely,

HOMER L. BRUCE.

AMHERST H. WILDER CHARITY,
St. Paul, Minn., July 23, 1951.

Hon. WALTER F. GEORGE,
United States Senator, Washington, D. C.

DEAR SENATOR GEORGE: We are writing to you as a member of the Senate Finance Committee to ask your assistance in securing an amendment to the section of the Revenue Act of 1951 which provides for a 20-percent withholding tax on dividends, royalties and interest payments. It is our understanding that the act as passed by the House of Representatives provides that the withholding tax shall be deducted from all dividend, royalty, and interest payments, but that where such payments are withheld from tax-exempt organizations, such organizations would be permitted to claim credit for the withheld amounts as an offset against their liability for income and social-security taxes on wages paid their employees. If the amounts withheld exceed the organization's liability for taxes withheld from wages paid their employees, the organization will have to apply for a refund of the difference.

The Wilder Charity is an endowed foundation which operates a number of services in this community for the benefit of "the worthy poor, sick, aged, or otherwise needy." With the exception of miscellaneous operating receipts, its entire income is received in the form of interest and dividends. If this proposed provision were to become law it would not only greatly complicate our bookkeeping records but would also delay the receipt of a substantial percentage of our current income. Because the Wilder Charity receives practically its entire income in the form of interest and dividends, the amount of our withholding-tax and social-security-tax credits would be equal only to approximately 25 percent of the amount withheld by the Government under the proposed plan.

It seems to us that the proposed plan would be exceedingly difficult to administer and that it would greatly increase the bookkeeping and record-keeping costs of the Federal Government.

The Wilder Charity owns some Canadian securities. Apparently the Canadian Government follows the practice of withholding the tax on payments of dividends, royalties, and interest, but it permits charitable organizations to file a certificate of their tax-exempt status with the company or individual paying the dividends, royalties, or interest, and on the basis of that statement no deductions are made with respect to payments to charitable organizations. It seems to us that such a procedure is much easier to administer and of much less inconvenience to the charitable or nonprofit organization. We would greatly appreciate your assistance in making certain that a more easily administered procedure is provided for tax-exempt organizations than the one proposed by the House bill. We have found that the Canadian system operates very easily, with a minimum of difficulty and delay for all concerned.

Thank you.

Sincerely,

F. M. RARIG, Jr., *Executive Secretary.*

NATIONAL TOOL AND DIE MANUFACTURERS ASSOCIATION,
Cleveland, Ohio, July 25, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: It will be very much appreciated if you will see that the following brief statement regarding family partnerships is included in the record of the hearings which your committee is now holding on H. R. 4473.

Full recognition of family partnerships by the Bureau of Internal Revenue as regards the Federal income tax is highly important to many of the shop owners in the special tool and die industry. These shops are all small businesses which make the special tooling without which mass production is impossible.

They are operated by their owners, frequently with the help of various members of the family, in the office, on the road, or in the shop. Family partnerships are a natural consequence, and take various forms.

Before the Senate acts on H. R. 4473, we urge that section 313, family partnerships, be amended to provide for its application for tax years back to 1938, and to make it clear that any partnership that is valid under State law be so recognized for Federal tax purposes.

Since it became permissible for husband and wife in any State to split their incomes equally in computing their income taxes, the importance of the validity of husband and wife partnerships has of course become of less importance. But before this right was established by Congress, many such partnerships which had been recognized for tax purposes before the United States Supreme Court decisions in the Tower and Lusthaus cases, were denied the right of dividing their incomes in accordance with their partnership agreements, even though this privilege of splitting incomes was enjoyed by all married couples in community-property States. This inequitable action should now be rectified, and other family partnerships fully recognized.

Sincerely yours,

GEORGE S. EATON, *Executive Secretary.*

AMERICAN WATERWAYS OPERATORS, INC.,
Washington 4, D. C., July 24, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington 25, D. C.

DEAR SENATOR GEORGE: Many members of this national association of the barge and towing-vessel industry who provide all types of domestic water transportation services on the inland rivers, intracoastal canals and waterways, the bays, sounds, and harbors of the Nation sincerely believe there is a serious inequity in section 448 of Public Law 909, Eighty-first Congress, the Excess Profits Tax Act of 1950, approved January 3, 1951.

Section 448 (c) (6) of the above-mentioned act permits the granting of a 6-percent credit—

"In the case of a corporation engaged in the furnishing or sale of transportation by common carrier by water, subject to the jurisdiction of the Interstate Commerce Commission under part III of the Interstate Commerce Act, or subject to the jurisdiction of the Federal Maritime Board under the Intercoastal Shipping Act, 1933"—

and section 448 (d) states that—

"For the purposes of this subchapter the term 'regulated public utility' means (except as provided in subsection (e)) a corporation described in subsection (c), but only if 80 per centum or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from sources described in subsection (c)."

As a matter of practical operations on the inland waterways and in the harbors of the United States, nearly all water carriers engage in both "regulated" and "unregulated" traffic under the provisions of part III of the Interstate Commerce Act—the Transportation Act of 1940. This act provides specific exemptions applicable to the carriers by water of bulk commodities generally, including bulk petroleum products, operations in harbors and contiguous waters, and certain other services provided by water carriers and operators.

Under the language in the Excess Profits Tax Act of 1950, herein quoted, domestic water carriers and operators are denied the 6-percent credit unless 80 percent or more of their traffic by revenue volume is subject to regulation by the Interstate Commerce Act. It is believed that the equitableness of the situation would require that these carriers and operators be permitted to take the credit referred to in the proportion of their "regulated" to their "unregulated" traffic and thus revenue.

Under such an arrangement, if a water carrier derived 50 percent of his revenue in any taxable year from traffic subject to regulation and fixation of rates by the Interstate Commerce Commission or any other appropriate regulatory body, he should be entitled to take 50 percent of the 6-percent credit, rather than be denied all such credit because of the fact that his "regulated" revenue did not amount to 80 percent of his total revenue for any taxable year.

It is hoped that the Committee on Finance will give consideration to the alleviation of this inequity in the Excess Profits Tax Act of 1950 by appropriate amendment to H. R. 4473, the proposed Revenue Act of 1951, now before it. The undersigned will be pleased to submit facts in support of this suggested amendment at your request, and I await your advice thereon.

Sincerely yours,

CHESTER C. THOMPSON, *President*.

JULY 23, 1951.

HON. HARRY F. BYRD,

Senate Finance Committee,

Senate Office Building, Washington, D. C.

DEAR SIR: In accordance with your request when I visited with you in your office Wednesday, July 18, I am attaching herewith a presentation of the proposed amendment of the House tax bill permitting partnerships and proprietorships to take advantage of the corporate tax rates in their business operations.

This group has been a neglected and forgotten group taxwise. There is little record of their ever having been given tax consideration as a business group. They form the backbone of American industry and commerce and are the breeding grounds of much of the best that is in the American enterprise system. They should be put on a competitive basis with corporations taxwise and I hope that you and your associates in the Finance Committee will see fit to make this recommendation to the Senate.

This is a new subject in one sense but it has been considered by your tax advisers for many years and has been before the Ways and Means Committee in the past. I believe it would have been given a great deal of consideration in the recent deliberations of the Ways and Means Committee if these had not been somewhat involved. We have never had a more able Finance Committee than the one presently serving the Senate and they are fully qualified to pick up this "new" subject and pass judgment on it.

Very truly yours,

F. N. BARD.

JULY 23, 1951.

PROPOSED AMENDMENT TO THE HOUSE TAX BILL NOW BEFORE THE SENATE FINANCE COMMITTEE

Subject: Giving proprietors and partners the right to pay business taxes under the same tax schedule as corporations.

The following taxes are presently in force:

	Percent
Corporation tax rates:	
Normal tax	25
Surtax on net income over $25,000	22
Total	47
Excess profits tax on income above excess profits tax credit if any	30
Total	77
Over-all ceiling, 62 percent.	
Individual tax rates:	
Normal tax	3
Surtax at $12,000	40
Surtax at $200,000	88
Top total rate	91
Over-all ceiling, 87 percent.	

A business earning $12,000 a year operated by a proprietor pays the same tax as a corporation, if the proprietor has no other income. If he has other income his business and personal taxes are added together and the burden on his business is increased.

Above $12,000 area income the proprietor is at a progressive disadvantage. The corporation rate is 47 percent plus excess-profits taxes, if any, with an over-all ceiling of 62 percent. The individual proprietorship ceiling is 87 percent.

It is recognized that by court decisions and tax authorities that no man should be penalized taxwise for his selection of a method of doing business.

All tax laws are written around the individual and the corporation and proprietor's and partner's business enterprises and venture capital has not been the subject of tax legislation. They are the forgotten group.

No other group will be hurt by recognizing this forgotten group and treating them justly taxwise.

The revenue received from this group by the Federal Government should not be reduced. This group should be stimulated and the revenue increased. Reduction of taxes increased the revenue in Canada.

This subject of proprietor and partner taxes has been before the Ways and Means Committee of the House since 1945 and has been considered by the Joint Tax Committee of the House and Senate. It has been stated that the reason the Ways and Means Committee has taken no action was because there was no general revision of the tax laws and only a few specific so-called emergency cases were passed on. The justice of an equitable tax base for this group has never been questioned.

A bill, H. R. 4214, was introduced into the House by the Honorable Daniel Reed, of New York this year and a similar one was introduced by the same Congressman last year.

Copies of H. R. 4214 are attached herewith and also a copy of a proposed bill differing slightly from H. R. 4214 which it is suggested that the Senate Finance Committee adopt as an amendment to the House bill presently before them in preference to H. R. 4214 for the following reasons:

The proposed and preferred amendment differs from H. R. 4214 in leaving out the last paragraph of H. R. 4214. This paragraph provides for double taxation of proprietorship and partnership when these earnings are transferred from the business account of the partnership or proprietorship to the individual account, i. e., transferred from his venture capital to his investment capital.

This is not a fair, equitable, or desirable procedure for the following reasons:

(1) Congress and its tax advisers are seriously considering the elimination of double taxation of corporate dividends. It would be unwise and unfair to impose on proprietorships and partnerships a double taxation of their earnings when the principal has been condemned in corporations.

(2) If a partnership or proprietorship is required to pay an extra tax for the transfer of earnings from venture capital to investment capital there will be a tendency to keep the venture capital and not pay taxes on it. Tax experts

have stated that the operation of a proprietorship and partnership tax based under corporate rates was the only method known by which the accumulations of unnecessary capital was prevented. The retention of capital by corporations has been the subject of much legislation and many administrative rules and an undesirable feature of this kind should not be added to a proprietorship and partnership tax situation.

(3) If venture capital earnings are transferred promptly from venture capital to individual investment account, without tax, they will immediately increase the earning power of the individual which earnings will be subject to the individual tax rates with probably increased revenue to the Government.

Proprietorships and partnerships are penalized over corporations as follows:

(1) They are required to pay taxes a year in advance and sometimes in advance of the collection of the money providing the taxes.

(2) They have, at the risk of their business, their entire assets, including both investment and venture capital.

(3) They have no carry forward on losses or excess profits tax credits.

Proprietorship and partnership advantages:

(1) The right to do business in any State without a license or incorporation.

(2) Bookkeeping and legal simplicity.

(3) No board of directors.

(4) No minority interest.

(5) No double taxation of earnings.

(6) No undistributed earnings problem.

(7) The right to do business in a manner of their own choosing without being penalized (a truly American privilege).

(8) No personal holding-company problems.

A BILL To permit unincorporated businesses to be taxed as corporations

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Internal Revenue Code is amended by adding at the end of part I of subchapter B of chapter 1 the following new section:

"SEC. 16. ELECTION AS TO TAX TREATMENT OF NONCORPORATE BUSINESS ENTERPRISES

"(a) At the election of the taxpayer, any business enterprise operated by an individual, or by a partnership consisting of not more than ten individuals other than a nonresident alien or a foreign partnership may be treated for tax purposes as if such business enterprise were a corporation, subject to the conditions and limitations provided in this section. In the case of a partnership, each partner must concur in the election. The election provided in this subsection shall be exercised in accordance with such regulations as the Commissioner, with the approval of the Secretary, shall prescribe.

"(b) As used in this section, the term 'business enterprise' means an enterprise engaged in a trade or business, other than personal service.

"(c) In the case of any business enterprise as to which an election for corporation tax treatment has been made under subsection (a), the following taxes shall be levied, collected, and paid:

"(1) a tax on the normal-tax net income of such business enterprise, at the rates prescribed in section 13 (b) or 14 (b);

"(2) a tax on the corporation surtax net income of such business enterprise, at the rates prescribed in section 15;

"(3) a surtax on the undistributed section 102 net income of such business enterprise, at the rates prescribed in section 102.

"(d) There shall not be included in the gross income of a business enterprise any income includible in 'personal holding company income,' as defined in section 502; but any such income shall be treated as the income of the individual or individuals to whom it would be attributable if this section had not been enacted. The Commissioner, with the approval of the Secretary, shall by regulation prescribe such method of accounting as will be necessary in order to determine what items are to be excluded from the gross income of the business enterprise and treated as income of individuals under this subsection.

"(e) In computing the net income of any business enterprise as to which an election has been made under subsection (a), the following rules shall apply:

"(1) a reasonable deduction shall be allowed for salary or compensation to the sole proprietor or to any partner for personal services actually rendered;

"(2) the treatment of capital gains and losses shall be that applicable to corporations;

"(3) a deduction for charitable contributions equivalent to that allowed by section 23 (q) shall be allowed;

"(4) there shall be allowed as deductions only such items as are properly allocable to the operations of such enterprise.

EFFECTIVE DATE

SEC. 2. The provisions of section 1 shall apply to taxable years ending after December 31, 1950.

WINTHROP, STIMSON, PUTNAM & ROBERTS,
New York 5, N. Y., July 20, 1951.

HON. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Would your committee be willing to take under consideration at this time a technical change in the new tax bill for the purpose of remedying a serious inequity which might well arise in connection with the optional valuation of a decedent's estate under section 811 (j) of the Internal Revenue Code? It might well happen that subsequent to the filing of the return and after the period within which an election to adopt either the value at date of death or the value 1 year after death has expired, the value of the gross estate may be increased over the value shown in the return either by including property not shown in the return, e. g., property transferred in trust and claimed by the estate to be not taxable, or by increasing the value of property shown therein, with the result that if the estate is bound by its election to use the value 1 year after death, the total tax resulting might substantially absorb the entire estate, or, so encroach upon it as to work a great hardship on the beneficiaries of the estate.

In the so-called American Bar Association tax bill by Representatives Camp and Reed, H. R. 4775 and H. R. 4825, there is proposed an amendment which would do away with the inequitable results under the present law. A copy of that proposed amendment is enclosed.

I appreciate that the bill which has been under your consideration is one designed primarily to increase revenue, rather than to correct inequities. Nevertheless, there is danger of a real hardship being incurred by an estate which I know of if the amendment to which I have referred is not passed at this time.

I should add that in order to be of benefit the amendment would need to provide that it be applicable to all estates with respect to which the statutory period for filing of claims for refund has not expired at the date of enactment. If the amendment were made applicable only to estates of decedents dying after the passage of the amendment it would not help the situation which I have in mind.

Faithfully yours,

PERCY W. CRANE.

PROPOSED AMENDMENT TO SECTION 811 (j) OF THE INTERNAL REVENUE CODE RELATING TO THE OPTIONAL VALUATION OF ESTATES

OPTIONAL VALUATION

Section 811 (j) (relating to optional valuation of gross estate) is hereby amended by striking out the first sentence and inserting in lieu thereof the following:

"(j) OPTIONAL VALUATION.—If the executor so elects upon his return, the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date 1 year after the decedent's death. If, subsequent to the filing of the return, the value of the gross estate is increased over the value shown in the return either by including property not shown in the return or by increasing the value of property shown therein, the executor may elect whether the gross estate, as increased, shall be valued as of the date of death or pursuant to this subsection, and the executor shall have this election notwithstanding a prior election or failure to elect. However, (1) property included in the gross estate on the date of death and, within 1 year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subsection (c), (d), or (f) of this section, distributed by the trustee under the instrument of transfer), or sold, exchanged, or otherwise disposed of, shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date 1 year after the decedent's death, and (2) any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time."

This amendment shall be applicable to all estates with respect to which the statutory period for filing a claim for refund of estate taxes shall not have expired at the date of the enactment hereof.

THE AMERICAN LEGION,
Indianapolis 6, Ind., July 30, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR: Since 1926 the American Legion has been very keenly interested in the promotion of baseball among the boys in the age group of 12 to 17 years. This was started as a part of the Legion's Americanism program, and has been continued each year.

We feel baseball has played a very important part in our program. It has also helped in correcting juvenile delinquency in many areas.

During 1950 a total of 16,456 teams were registered in our American Legion junior baseball program. Although many Legion teams were playing who were not officially registered in our headquarters office. We estimate 1 million boys participate in our baseball program annually.

In view of the effort the American Legion is making to interest the boys of ages 12 to 17 in baseball, it is our feeling that baseball equipment such as balls, bats, gloves, masks, body protectors, and leg guards should be removed from section 483 of H. R. 4473, which is now being considered by your committee.

We were unable to appear before your committee, and will appreciate it if this letter can be made a part of the record of the hearing.

Sincerely yours,

ERLE COCKE, Jr., *National Commander.*

THE AMERICAN GUERNSEY CATTLE CLUB,
Peterborough, N. H., July 27, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: This organization is the American Guernsey Cattle Club, Peterborough, N. H., representing approximately 50,000 Guernsey cattle breeders in the United States.

The Senate Finance Committee, of which you are chairman, is considering the new Revenue Act of 1951, and we would like to direct ourselves briefly to one provision of the bill (H. R. 4473) as it was passed by the House. We refer to section 306 of the bill, which reads:

> "Effective with respect to taxable years beginning after December 31, 1950, section 117 (j) (1) is hereby amended by adding at the end thereof the following new sentence: 'Such term also includes livestock held by the taxpayer for draft, breeding, or dairy purposes for 12 months or more.'"

This provision is of vital interest to our members, as well as to the countless thousands of taxpayers in this country who have herds of animals used for draft, breeding, or dairy purposes.

Obviously, the intention of the provision is to make sure that the taxpayer shall receive a capital-gains treatment when he sells draft, breeding, or dairy livestock, with the requirement that in order to get such treatment, the livestock must have been "held by the taxpayer" for such purposes for 12 months or more.

You and your committee are undoubtedly familiar with the history of the taxability of sales of draft, breeding, or dairy animals. Without attempting to set forth the details, the Commissioner of Internal Revenue, for years, has been holding that sales of such animals result in ordinary income, notwithstanding the fact that the judicial decisions have been to the contrary. Your honorable committee, and the Congress, was most cognizant of this situation last year when it considered the insertion of a provision on this subject in the Revenue Act of 1950. However, for certain reasons, this was not done and we refer to the conference committee report (H. Rept. No. 3124, 81st Cong., 2d sess., p. 28) which said: "It is the hope of the conferees that, pending such study and further legislation, the Treasury Department will follow the decision of the Eighth Circuit Court in the Albright case (173 F. 2d 339)." The conferees had eliminated the proposed amendment because they did not want to amend section 117 (j) with regard to cattle to the exclusion of other livestock and, accordingly, felt that the matter on an over-all broad basis was deserving of further study.

Since then, the Treasury Department has come out with a new position set forth in Mim. 6660 (June 27, 1951), but in this ruling the Commissioner still has not gone as far as some of the court decisions.

Obviously, and especially in view of what happened last year, the intent behind section 306 of the pending revenue bill is to afford taxpayers certain benefits and to make sure that they receive them, notwithstanding what the position of the Commissioner may be.

However, we would like to point out to you that the language in the bill lacks clarity and could very well result in considerable litigation which would be costly to taxpayers, as well as the Government, and which might very well defeat the intent of this new legislative provision. While the language to be added to section 117 (j) refers to livestock "held by the taxpayer" for 12 months or more, there is no way of determining when such holding period begins. The report of the House committee accompanying this bill (H. Rept. No. 586, 82d Cong., 1st sess.) sheds no light on this at all. It states:

> Your committee believes that the term "livestock" in this new sentence should be given a broad, rather than a narrow, interpretation; and that the gains from sales of livestock should be computed in accordance with the method of livestock accounting used by the taxpayer and presently recognized by the Bureau of Internal Revenue.

To give you a specific example, let us refer to a bull which is owned by the owner of a dairy herd. The bull cannot be used for breeding until it is from 10 to 12 months old. When does a taxpayer begin to hold such an animal for breeding purposes? Once the bull calf is born in the taxpayer's herd the taxpayer begins holding it for breeding purposes.

The same is true with regard to a heifer calf. It would not be bred until about 18 months of age and would first drop a calf about 9 months thereafter. Yet, once the heifer is born in the taxpayer's herd, with the taxpayer not selling it but holding it in the herd, with the attendant expenses, taxpayer is holding such animal for dairy or breeding purposes.

By the same token, once a taxpayer obtains title to a bull or heifer that date should start his 12 months holding period.

In order to avoid confusion and considerable costly litigation in the future, and in keeping with the apparent intent behind this provision, it is requested that your honorable committee modify this language so as to make it crystal clear when the holding period begins.

Knowing how busy your committee is, with numerous witnesses requesting permission to appear before it, we are attempting to cooperate with you and are confining our request to the form of this letter. We trust you will be good enough to see to it that it receives the attention of yourself and your honorable committee. If you or your committee so desire, we would be glad to personally appear before it to discuss this particular subject at greater length.

Thanking you for your consideration.

Respectfully,

THE AMERICAN GUERNSEY CATTLE CLUB,
KARL B. MUSSER, *Secretary.*

(At 12:40 p. m. the committee recessed to reconvene at 10 a. m. Monday, July 30, 1951.)

REVENUE ACT OF 1951

MONDAY, JULY 30, 1951

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

The committee met, pursuant to recess, at 10 a. m. in room 312 Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd, Kerr, Frear, Taft, Martin, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. Let the meeting come to order.

In lieu of appearance there will be inserted in the record a letter from John W. Hardy, of the Virginia Alcoholic Beverage Control Board, Richmond, Va., and the statement of Karl F. Feller, president, International Union of United Brewery, Flour, Cereal, Soft Drink, and Distillery Workers of America, CIO.

(The material referred to follows:)

COMMONWEALTH OF VIRGINIA,
VIRGINIA ALCOHOLIC BEVERAGE CONTROL BOARD,
Richmond, Va., July 25, 1951.

Hon. HARRY F. BYRD,
Congress of the United States, Senate Building, Washington, D. C.

DEAR SENATOR: As president of the National Alcoholic Beverage Control Association and vice chairman of the Virginia Alcoholic Beverage Control Board, I am enclosing a copy of a resolution which was adopted at the annual meeting of the National Alcoholic Beverage Control Association held in New York City on October 4, 1950, which resolution was reiterated at a midyear meeting of the association held at White Sulphur Springs, W. Va., on May 2, 1951, relative to the matter of excise taxes on alcoholic beverages. This association is composed of 16 member States who have alcoholic beverage control laws similar to the laws of the State of Virginia. The members of the Virginia Board have had the privilege of meeting once or twice a year with the commissioners and administrators of the other commissions who are members of this association for the purpose of improving the administration and enforcement of laws pertaining to the sale of alcoholic beverages. I wish to say that these are earnest, honest, honorable men devoting their talents in a conscientious manner in an attempt to control the distribution of alcoholic beverages and to eliminate, as far as practical, illegal manufacture and traffic of such beverages. The members of this association, including the Virginia board, are opposed to any increase in Federal excise taxes on alcoholic beverages as expressed in the enclosed resolution.

We feel the Federal Government will make a grave error if any additional taxes are imposed on any alcoholic beverages. In our opinion any increase in taxes will contribute to an alarming increase in illegal manufacture and traffic in alcoholic beverages with a resultant increase in other types of crime. We believe that it would be necessary for the various States and the Alcohol Tax Unit to substantially increase their personnel at great expense to both the Federal and State Governments in an attempt to control illegal manufacture and traffic and there is great doubt in our minds that even with increased personnel, the illegal manufacture and traffic can be controlled satisfactorily.

We cannot agree with the philosophy of those who believe the illegal manufacture and traffic of alcoholic beverages which would be caused by additional Federal excise taxes would not create a serious crime problem for the enforcement agencies of the Federal and State governments.

We respectfully request your serious consideration of this matter, and we hope it will be your pleasure to vote and use your influence as a member of the Senate Finance Committee against the present proposed increase in excise taxes on alcoholic beverages.

We respectfully request that at the meeting of the Senate Finance Committee to be held in Washington next Monday you present this communication and the enclosed resolution and request that it be made a part of the record of the hearing to be conducted at that time relative to the matter of excise taxes on alcoholic beverages.

With kind personal regards,

Sincerely yours,

JOHN W. HARDY.

RESOLUTION

Whereas the present Federal excise tax rate on alcoholic beverages already bears two war tax increases, the first assessed under the Revenue Act of 1942 and the second assessed under the Revenue Act of 1948;

And whereas there has been an alarming increase in the illicit production of distilled spirits as reflected by the still-seizures statistics released by the Alcohol Tax Unit of the Treasury Department of the United States and which indicates that such illicit production continues to increase;

And whereas it is the opinion of the National Alcoholic Beverage Control Association that excessive excise taxes on distilled spirits are a major contributing factor to such illicit production:

And whereas such excessive taxes and consequent illicit production have a direct and an adverse influence on the revenue of the member States of this association, first by diverting the revenues which would normally accrue to the said member States from the sale of legal tax-paid distilled spirits, and secondly by adding to the enforcement costs consequent upon the illicit traffic in distilled spirits within the borders of the said member States: Now, therefore, be it

Resolved, That the National Alcoholic Beverage Control Association urges that there should be no further increase in the excise tax rates on alcoholic beverages; and it is further

Resolved, That the executive secretary of this association send a copy of this resolution to all of the members of the Ways and Means Committee of the House of Representatives and to all of the members of the Finance Committee of the Senate.

STATEMENT OF KARL F. FELLER, PRESIDENT, INTERNATIONAL UNION OF UNITED BREWERY, FLOUR, CEREAL, SOFT DRINK, AND DISTILLERY WORKERS OF AMERICA, CIO.

My name is Karl F. Feller and I reside at 3106 Manning Avenue, Cincinnati, Ohio. I am president of the International Union of United Brewery, Flour, Cereal, Soft Drink, and Distillery Workers of America affiliated with the Congress of Industrial Organizations. For the sake of brevity I will refer to it as the Brewery Workers Union.

The Brewery Workers Union, whose headquarters are at Cincinnati, Ohio, represents the overwhelming majority of the employees in the brewing industry in this country and a very substantial segment of the employees in the distilling industry. It also represents, among others, the employees in the yeast, malt, and other industries which are related to the alcoholic-beverage industries. It is on behalf of the approximate 75,000 employees whom we represent in these industries that I appear before you today to oppose the proposed increases in the excise taxes on beer and distilled spirits, H. R. 4473.

Since its foundation in 1886, the organization which I am proud to represent has dedicated itself to improving the living standards and working conditions of its members and of the workers of this country in general. As one of the pioneers of the American labor movement, the Brewery Workers Union has its roots deep in the American democratic tradition. Political and economic democracy are objectives for which our union has fought in the past and to which we have dedicated ourselves for the future. I mention these things to emphasize the statement that we recognize fully the seriousness of the present crisis on both the domestic and international fronts. We recognize the danger of totalitarianism to our democratic institutions and we also recognize the need for the raising of additional revenue to put a brake on the inflationary spiral and to defray the tremendous cost of our armaments program.

However, from the standpoint of the welfare of our members and the general welfare as well, the proposed increases in the excise taxes on alcoholic beverages are unfair, ill-advised, and shortsighted. It is questionable whether they will yield substantial additional revenues. On the other hand there seems little doubt that such tax levies will bring evils in their train which will far outweigh any additional revenues which they may produce.

It is well known that taxation of alcoholic beverages has often been used for the dual purpose of raising revenue and controlling consumption. The latter approach is, of course, the backdoor approach to national prohibition. I assume that the proposed levies are intended to produce additional revenue and are not being considered as a prohibition measure. I assume that this committee and this Congress are too well aware of the social catastrophe which is called the noble experiment to even contemplate its restoration. At the same time, it is only fair to point out that the fanatical forces of prohibition, which are ceaselessly active in our National and State capitals, view any increase in alcoholic-beverage taxes as a step toward prohibition. They realize the truth of the statement that "the power to tax is the power to destroy." Those who would destroy the alcoholic-beverage industry will enthusiastically support any proposal which will place a crippling burden upon the already overtaxed beer and liquor industries. We submit that this committee in its deliberations should disregard completely any control or prohibition arguments or consideratons. This committee and this Congress have no mandate to reintroduce national prohibition. They are concerned only with a revenue measure, intended solely to increase our Goverment's income in time of serious national emergency. It is from that standpoint alone that I propose to discuss these proposed taxes (H. R. 4473).

At the very outset the attention of the committee is called to the fact that the wartime excise taxes on alcoholic beverages which were imposed during World War II are still in effect although they were intended to be only for the duration of the emergency. It is now proposed that a further wartime tax be superimposed on the existing one. I suggest to the committee that this process is similar to the imposition of an additional excess-profits tax on corporations on top of those which were imposed during World War II. Such a proposal would be denounced as obviously unfair and confiscatory. It does not become any fairer because this proposal is leveled solely at alcoholic beverages. It is still a case of one emergency wartime tax on top of another.

We protest, in particular, any additional tax on beer. To place this additional burden on an already overburdened beverage may well place it beyond the reach of the public and destroy the industry. It is commonly said that beer is the workingman's drink, and this is largely true. But the size of the beer glass has been shrinking in recent years and its price has been rising. The tax burden on beer is fantastically heavy. Starting with a Federal tax of $5 per barrel in the postprohibition period, the impost was raised until it reached its present rate of $8 per barrel in 1944. But this is only the beginning. Every State and the District of Columbia levy a tax on the manufacture or sale of beer. On December 1, 1950, these State taxes ranged from 62 cents per barrel in California to $14.40 in South Carolina. State taxes average more than $2 per barrel. In addition, there are other local taxes, Federal and State license and permit fees for breweries, wholesalers, and retailers. All of these are, of course, in addition to such general taxes as Federal and State corporation income taxes and other taxes of general application. In many States proposals are now under consideration for increasing State taxes on beer. The theory seems to be that there is no limit to the tax burden that can be placed on beer. We submit that the saturation point is here and that the time has come to call a halt. We are not dealing with a luxury item. Beer is a beverage for the masses, not to be treated in the same manner as expensive jewelry or expensive furs or perfumes. It is a beverage that the American worker has the right to enjoy. It must not be placed outside his reach through excessive taxation.

There is evidence that we have reached the point of diminishing returns in regard to beer taxes. The combination of Federal and State taxes seems to be reducing beer consumption. Thus, since 1947 there has been a steady and substantial decline in Federal revenue from taxes on beer as shown by the following table compiled from reports of the Bureau of Internal Revenue:

1947	$702,988,868
1948	685,170,475
1949	674,010,638
1950	662,004,017

It is plain that in a period of economic prosperity and increased consumer income the Federal tax yield from beer has been declining. This picture is not one which justifies an increased tax burden on beer. The increased tax under consideration may very well result in less revenue.

It is commonly stated, and I sincerely believe, that this increased tax will drive scores of small breweries out of business and hasten the pronounced trend in the industry toward concentration and monopoly. The small breweries in this country were looking forward to a reduction in the excise tax on beer last year, with anticipation and hope. Not only has that hope been crushed, but it is now proposed to lay an even greater burden upon them. Many will not survive it.

We submit that any tax program which has such undesirable consequences should be scrutinized very closely. It places an unfair and excessive burden upon a staple, workingman's beverage; it places an unfair and excessive burden upon one American industry; it will lower consumption, produce reduced revenues, and aid in the destruction of small business. There is a point beyond which beer cannot be taxed and that point has been reached. An industry which is now one of our greatest revenue-producers may well be placed in jeopardy by such a tax program.

We turn now to the proposed increased taxes on distilled spirits. Some of the things which I have said about beer taxes are applicable to distilled spirits as well, especially the matter of pyramiding one emergency wartime excise tax on another. However, we ask you to consider what seems to us to be the most serious problem in this connection, namely, the probability of the return of many of the worst evils of the prohibition era in the event that these added taxes are imposed. We could spend a great deal of time arguing and debating statistics. This would serve no useful purpose, because the problem may be posed in very simple, common-sense terms. H. R. 4473 proposes to increase the tax on distilled spirits from $9 to $10.50 per proof gallon. On top of this $10.50 per proof gallon tax we have the multiplicity of State taxes which averaged about $1.48 per tax gallon in 1949, plus Federal, State, and local taxes and license and permit fees. There is a strong trend among State and local governments to increase existing taxes on alcoholic beverages. There is a stern warning in these facts which may be stated in the following terms: When taxes force retail prices above a certain level the bootlegging of alcohol on which no tax has been paid becomes attractive to lawless elements. Let us not delude ourselves. As soon as even a slight tax is imposed there is an incentive to evade the tax. The higher the tax, the greater the incentive.. The existing $9 tax plus the numerous State and local taxes already provide a tremendous incentive for lawbreaking. Increase that tax by $1.50 and you are inviting moonshining, bootlegging, and organized crime on a national scale.

It is estimated by the Licensed Beverage Industries, Inc., based on data of the Alcohol Tax Unit, Treasury Department and reports of the various states, that in 1949: 8,008 stills were seized by Federal agents and 10,876 by State and local authorities, for a total of 18,884 seizures. It is also estimated by the same source that these stills had a daily capacity of over a half-million gallons, or more than 100,000 gallons per day above the average daily production of the legally licensed distillers. These figures are impressive, but they do not tell the worst of our fears of what may happen if this additional tax should be placed on distilled spirits. We solemnly warn that taxes at that level will surely herald the return of the mobster, the racketeer, and the hijacker to our national scene; of the bootlegger and the speakeasy; with all their attendant evils. It would be an invitation to organized crime on a national scale.

We submit that these proposed increases of the taxes on beer and distilled spirits should be rejected. The existing wartime emergency taxes on these products are high enough. We commend to this committee the tax program recommended by the Congress of Industrial Organizations, which will yield adequate revenue to the Government and place the burden upon those elements in our economy which are best able to pay it. Let us not impose taxes which may well undermine the brewing industry, place the worker's beverage beyond his reach or encourage large scale violations of the law and organized crime, taxes which are so high as to make it likely that they will produce no additional substantial revenue. It is probable that a very large part of any additional revenue that these taxes might yield would be expended for law enforcement in a futile attempt to cope with the lawlessness which excessively high excise taxes invite.

Senator BYRD. In lieu of appearance there will be inserted in the record a statement from Mr. Frank Ludwick, counsel for the Bottle Fermented Champagne Producers, Inc.

(The letter referred to follows:)

BOTTLE FERMENTED CHAMPAGNE PRODUCERS, INC.,
Washington, D. C., July 25, 1951.

SENATE FINANCE COMMITTEE,
United States Senate,
Washington, D. C.

GENTLEMEN: The Bottle Fermented Champagne Producers, Inc., a trade association composed of producers of fermented-in-the-bottle champagne in the United States, is a signatory of the brief filed with your honorable committee by the Wine Conference of America representing the wine industry as a whole.

Since we know of no commodity so discriminated against taxwise as champagne we desire to file this supplemental brief with a prayer for an equitable adjustment of the excise tax on champagne.

Champagne is simply a light table wine which has undergone a second fermentation which does not change the alcoholic content from that of the original light table wine but which produces a carbon dioxide gas causing the wine to sparkle and effervesce when opened.

It is a recognized fact that the American public prefers carbonated drinks whether they be nonalcoholic or moderately alcoholic.

The only possible reason for the excessive and discriminatory tax on champagne is that it has erroneously been considered to be a luxury item. The only reason it may be so considered is because of the excessive tax. The tax proposed on table wine of the same alcoholic content as champagne in H. R. 4473, now being considered by your honorable committee, amounts to 17 cents per gallon as compared with what amounts to a tax of $3.40 per gallon on champagne.

Mr. Frank Schoonmaker, a wine importer and an author of books on wines, appearing before the Committee on Agriculture of the House of Representatives in the Eighty-first Congress, on this subject said:

"All of us in America are aware that our eating and drinking habits are not those of European countries. America's club, so to speak, is the soda fountain, not the cafe. Coca-Cola has acquired a popularity which even seems to frighten some of our good friends in France. We have ginger-ale and seven-up, sarsaparilla, and beer. Some of these drinks are sweet, and some are not, and they have all sorts of different flavors.

"What do they have in common?

"One thing, gentlemen, they are carbonated. Apparently Americans like bubbles. Americans get bubbles every time they open a bottle of a soft drink. They get bubbles every day across the soda fountain. If you ask for a glass of beer in England, you get a brew that has no sparkle at all, but you could not sell that kind of beer in the United States. We like bubbles; we like drinks that sparkle. Ordinarily this innocent liking for sparkling beverages does not involve us in taxation. The bubble, like air, is free. Congress does not tax ice-cream sodas because they are carbonated, or Coca-Cola because it sparkles, but what a man pays in the way of Federal taxes on a whisky and soda is no higher than the tax that he pays on a whisky and water. Why, then, do we have a major discrimination against sparkling wine? The other products that I have mentioned, excellent as they may be, are not farm products. Why deny to the farmer, the grape farmer, the wine producer, a right to put a few bubbles in the wine he makes? Our national laws, since the repeal of prohibition, tax alcohol, not bubbles. Do you not think that we might stop discriminating against the only alcoholic beverage which is a farm product, and give the farmer a chance to put untaxed bubbles, a sparkle without a tax, in his wine to make it more salable and more acceptable to the general public?

"Champagne the world over gets a lot of publicity. And actually the very word 'Champagne' has somehow become synonymous with luxury and high living. But let us not forget that not so many years ago, tea and coffee and oranges and lemons were also products restricted to the very wealthy. Today they are on practically every table in the United States. They would not be if they had been prohibitively taxed.

"American sparkling wine, or champagne if you prefer to call it that, can too, take its honorable place on America's dinner table, particularly America's festive dinner table. The American sparkling wine industry is in its infancy. It is hardly even in its infancy—it scarcely exists. I venture to say that 90 percent of Americans have never tasted sparkling wine. Those that have seem to like it, but in 1949 we consumed just about one tablespoon of sparkling wine per capita.

"Through an altogether excessive and unreasonable tax on sparkling wine, and in order to produce less that $5,000,000 in internal revenue taxes, the Government has effectively prevented the expansion of what is potentially a major industry—an agricultural industry—which could, if properly and fairly taxed, yield many times $5,000,000. All of the sparkling wine now consumed in America can be produced by something like 20,000 acres of vines, and I can personally assure you that the farmers that grow and cultivate these vines are not having any too easy a time, and are not very happy. I suggest that if you give them a break as far as Federal taxes are concerned within 3 or 4 or 5 years you may well see a million or two million acres under similar vines, and the farmers doing very well indeed.

* * * * * * *

"Third, I believe that a certain amount of careful study will convince you, gentlemen, that a reduction of the tax on sparkling wine will produce more revenue rather than less revenue, and, at the same time, make a major contribution to the prosperity of American agriculture."

Consumption of champagne in France in 1950 amounted to an average of a half bottle per person or one-tenth of a gallon. The consumption of all sparkling wines in the United States in 1950 amounted to about one one-hundredth of a gallon per person (this includes United States and foreign produced champagne). On the basis of population in the United States if each person consumed one-half bottle of champagne as they did in France in 1950 sales would have amounted to about 6,050,000 cases per year as compared with 714,000 cases. Even allowing for the difference in the customs of the two countries it must be admitted that the tax element is important. The United States taxes champagne at the present time $3 per gallon as compared with the French tax of 8 cents per gallon.

As a result of the last discussion of import duties at the Torquay, England, tariff conference the duty on champagne valued under $6 per gallon was reduced from $3 per gallon to $1.50 per gallon as had been previously done for champagne valued over $6 per gallon.

The attached table shows that United States champagne is not keeping pace with the growth of sales of all classes of United States produced wine. On the other hand, French champagne sales have increased in proportion to all foreign wine sales apparently at the expense of United States champagne producers. Many United States champagne producers have already been forced out of business as will most of those remaining unless the tax is reduced sufficiently to permit an increased consumption of the product.

In addition to the exorbitant excise tax on champagne the method of levying the tax is likewise unscientific and unfair. Extended research has failed to determine why the half-pint unit was selected as the taxable unit for champagne as opposed to the 1-gallon unit for most other alcoholic beverages. Whatever reason, if any, which may have existed for its justification at the time of its adoption the reason no longer exists. Champagne is universally packaged in one-fifth gallon bottles or fractions thereof and the tax therefore could readily be determined on a gallonage basis. Levying on a half-pint unit basis it results in a tax in excess of what the Congress evidently intended by reason of the fact that the half-pint units cannot be adjusted to the traditional champagne package, impossible to change in the face of French champagne competition. So the present tax of 15 cents per half-pint unit reduced to a gallonage basis theoretically amounts to $2.40 whereas actually it amounts to $3. Sixty cents is therefore paid on champagne that simply does not exist. We submit this is unscientific, unfair, and discriminatory.

Because of the ad valorem of champagne compared with table wines, resulting from the increased cost of the second fermentation, a higher tax should probably be imposed upon champagne. It should be somewhere in the neighborhood of that imposed upon dessert wine (67 cents per gallon) by the proposed legislation. At most it should certainly not exceed the present theoretical tax of $2.40 and the tax should be imposed on the same honest taxable unit applicable to other wines and distilled spirits.

Respectfully submitted.

BOTTLE FERMENTED CHAMPAGNE PRODUCERS, INC.,
By FRANK M. LUDWICK, *Counsel*

Year	United States wine			Foreign wine			Grand total, champagne	
	Sparkling	All wines	Percent of total	Sparkling	All wines	Percent of total	Gallons	Cases
1930-40 average	410,014	68,410,110	0.006	512,619	3,967,473	0.130	922,633	384,430
1941	918,117	99,815,805	.009	103,645	1,628,877	.063	1,021,762	421,567
1942	844,618	112,035,077	.007	98,112	1,009,076	.097	942,825	392,843
1943	1,206,971	93,426,508	.013	84,043	4,075,029	.020	1,290,014	537,506
1944	1,394,670	90,875,828	.015	86,981	8,079,404	.010	1,481,660	617,358
1945	1,418,864	91,308,040	.015	148,556	2,666,696	.056	1,566,920	652,883
1946	2,054,858	135,435,896	.014	546,741	4,879,928	.111	2,600,599	1,083,582
1947	1,009,584	94,303,145	.010	181,974	2,207,173	.080	1,191,558	496,482
1948	1,062,796	119,389,370	.009	375,295	2,900,537	.129	1,438,091	599,206
1949	1,045,323	129,372,918	.008	431,119	3,194,556	.134	1,476,442	615,284
1950	1,120,677	135,021,808	.008	592,044	4,667,284	.127	1,712,321	723,883

Senator BYRD. In lieu of appearance there will be inserted in the record a statement from Mr. Jacob Rock on behalf of the Beauty and Barber All-Industry Legislative Council.

(The document referred to follows:)

STATEMENT OF JACOB ROCK ON BEHALF OF BEAUTY AND BARBER ALL-INDUSTRY LEGISLATIVE COUNCIL

My name is Jacob Rock. I am the Washington representative of the Beauty and Barber All-Industry Legislative Council, a group consisting of officials of organizations representing all segments of the beauty and barber industry—shopowners, supply wholesalers, and manufacturers.

The beauty and barber industry supports section 432 (b) of H. R. 4473 the Revenue Act of 1951, amending the provisions of section 2402 (b) of the Internal Revenue Code, and urges the Committee on Finance to retain it in the tax legislation to be reported to the Senate.

Section 432 (b) of H. R. 4473 provides beauty and barber shops with the relief they so desperately need from the burdensome procedural provision resulting from the Federal retailers' excise tax on bulk toilet preparations used by beauty and barber shops in rendering services.

Beauty and barber shops want to pay their just share of the increased taxes needed to support mobilization. However, they join other industries, affected by excise tax hardships, in stating that if excise taxes must remain on the statute books for an indefinite time, then it is imperative that the glaring inequities and unreasonable hardships created by these taxes be adjusted by Congress now. We feel that the necessity for raising additional revenue must not be used as an excuse for not levying excise taxes equitably and fairly especially since excise taxation now appears to be a permanent fixture in our tax structure.

The Committee on Ways and Means which has carefully considered excise-tax inequities and hardships on three occasions in the past 5 years recognized the injury occasioned to the beauty and barber industry by the discriminatory, burdensome procedure which must be followed in connection with the tax on bulk cosmetics used in rendering services when it incorporated section 432 (b) in the Revenue Act of 1951. Hon. Robert L. Doughton, chairman of the Committee on Ways and Means, made this statement on the floor of the House of Representatives regarding the provision granting relief to beauty and barber shops from the tax on bulk cosmetics used in rendering services:

"This bill was carefully considered and unanimously reported out by the Committee on Ways and Means. After full consideration, it was decided that it is a meritorious bill."

Most of the members of the Committee on Finance are familiar with the facts of the hardship imposed on the beauty and barber industry by procedural provisions of the tax on bulk cosmetics used in rendering services. A statement was filed with your committee on this subject in July 1950 during the consideration by it of the 1950 tax bill. Moreover, a complete statement on the hardship suffered by the beauty and barber industry as a result of the tax on bulk cosmetics is set forth in the report of the hearings before the Committee on Ways and Means on revenue revision of 1951, in part 3, at pages 2529 to 2533. Accordingly, and in order to conserve your valuable time, I will summarize, instead of fully developing at this point, the reasons why the beauty- and barber-shop industry should be accorded relief, as provided in section 432 (b) of H. R. 4473, the Revenue Act of 1951, from the procedural provisions of the retailers' excise tax on bulk cosmetics used in rendering services:

1. This retailers' excise tax is harmful to beauty and barber shops since it places an undue burden on such shops selling cosmetics by requiring them to furnish each supply dealer with a frightening certificate of purchase for resale and has caused many shops to refrain from selling cosmetics thereby causing them to lose income they normally would derive from such sales. This requirement is not imposed on other retailers of cosmetics.

2. This tax represents the taxing of business-cost items and adds to the operating costs of beauty and barber shops. The major portion of shop revenue is derived from rendering services, and cosmetics are part of the operator's tools. This tax is a levy on the tools of persons earning a living with their hands.

3. If section 432(b) of H.R. 4473, the Revenue Act of 1951 is enacted, there will be no apparent loss of revenue to the Government. It is estimated that about $3 million is collected annually as a result of this tax. The apparent loss of this small amount would be more than offset by the increased tax yield from retail sales by beauty and barber shops in a broadened retail market. Moreover, an increased income-tax yield would also follow reduced business costs and enlarged volume of sales at retail by beauty and barber shops.

4. This tax is difficult to administer since some beauty and barber shops are both users and resellers of cosmetics. A realistic enforcement of the law would cost the Government an amount entirely out of proportion to the small amount of revenue it receives from the tax on professionally used cosmetics.

5. The procedural requirements for the certificate of purchase for resale imposed by the Bureau in connection with this tax, place beauty and barber shops at a competitive disadvantage with other retailers of cosmetics since it requires such shops to pay the 20-percent tax to the wholesaler if the certificate is not furnished whereas other retailers of cosmetics are not required to furnish their wholesaler with such certificates or pay the tax in lieu thereof.

6. This tax places an undue burden on small beauty and barber shops since the Bureau regulations require considerable, complicated record-keeping which requires the expenditure of time and energy by small-shop owners and frequently adds to their expense due to the necessity for employing accountants or attorneys.

I wish to emphasize that section 432 (b) of H. R. 4473, the Revenue Act of 1951, does not exempt retail sales of toilet preparations or cosmetics by beauty and barber shops. The resale of cosmetics at retail by beauty and barber shops will continue to be taxable, as under present law, under the provisions of section 432 (b) of the proposed Revenue Act of 1951 and we are in complete agreement with that provision.

Reference is made to House Report No. 586 of the Committee on Ways and Means accompanying H. R. 4473, the Revenue Act of 1951, particularly the following portion (p. 51) giving its reasons for affording beauty and barber shops relief from the provisions of the excise tax on bulk cosmetics intended for use in rendering services:

"The second change exempts toilet preparations purchased by barber shops and beauty parlors for use in these establishments. Under present law these items are subject to tax at the time they are purchased by a barber shop or beauty parlor. However, toilet preparations purchased by a barber shop or beauty parlor for resale to customers are not taxable until sold to the ultimate user. To distinguish from the purchases for resale made by the barber shop or beauty parlor from the purchases for their own use, the establishment is required to file a certificate if no tax is paid at the time of purchase indicating that the items will not be used in the establishment. Such certificates are not presently required in the case of tax-paid purchases for use in the establishment. This difference in treatment has resulted in considerable confusion among the barber shop and beauty parlor operators. Moreover, the taxing of the items used in the establishment itself represents the taxing of business cost items. The bill eliminates these problems by repealing the tax on toilet preparations purchased by barber shops, beauty parlors, and similar establishments if intended for use in such establishments."

We desire to amplify, for the benefit of new members of the committee, some of the above reasons why the tax relief requested should be granted. Beauty and barber shops are treated differently from other retailers of cosmetics under existing law and regulations due to the fact that such shops are normally both consumers and retailers of cosmetics. This discriminatory treatment has caused many shops to refrain from retailing cosmetics, thereby causing them to lose income they would normally derive from such retail sales. Section 2402 (a) of the Internal Revenue Code imposes a 20-percent tax on all retail sales of cosmetics to consumers. Under Buerau regulations, department stores, drug stores, etc., selling cosmetics to the public are required to collect the tax, keep records, report and pay the taxes collected to the Government monthly—and nothing more. All this is also required of a beauty or barber shop selling cosmetics plus something else which is not required of other retailers. When a beauty shop sells cosmetics, the Bureau regulations require the beauty-shop owner to sign and deliver a certificate of purchase for resale to each wholesaler from whom she buys cosmetics intended for resale or else pay the 20-percent excise tax. No other retailer of cosmetics is required to furnishe the wholesaler with a certificate and no other retailer is required to pay to the wholesaler the 20-percent tax if such certificate is not furnished.

The Bureau's reason for requiring the beauty- or barber-shop owner to either furnish a certificate to the wholesaler or pay the tax when buying cosmetics for resale arises from the fact that the 1942 Revenue Act makes a distinction between sales of cosmetics to beauty or barber shops for use in their operation and sales to such shops for resale. A sale of cosmetics for use in a beauty or barber shop is considered in section 2402 (b) as a retail sale and the beauty-shop owner when making purchases of cosmetics for us must pay the wholesaler the 20-percent tax. On the other hand, the 1942 act considers a sale by the wholesaler to the beauty shop of cosmetics purchased for resale as a wholesale transaction and not as a taxable retail sale unless the shop subsequently uses the cosmetics and then what was originally a wholesale transaction becomes a taxabe retail sale. Although a shop pays no tax when purchasing cosmetics for resale it does collect and pay a tax when it sells the goods.

The Internal Revenue Bureau ruled that the 1942 act amended section 2402 (b) so as to continue to tax those sales of cosmetics to beauty or barber shops which are for use in their operation but to exempt from the tax cosmetics sold to such shops for resale by wholesalers. The Bureau held that the question of whether a cosmetic is sold to a shop for use or resale is dependent upon the intent of the beauty-shop owner making the purchase. Thus, the Bureau ruled that Congress, through the 1942 amendment created a tax exemption on cosmetics sold to beauty or barber shops for resale but held that the shop owner buying the cosmetics for resale must express, in a certificate of purchase for resale, that the cosmetics are purchased for resale in order to be exempt from the payment of the tax to the wholesaler supplier and that she will be liable for the 20 percent tax if resold or used.

I have tried to briefly explain the complicated provisions of the law and regulations dealing with the tax on cosmetics as it affects beauty and barber shops. The regulation contains further provisions requiring wholesaler suppliers and beauty- or barber-shop owners who resell cosmetics to keep and maintain complicated records. However, I would only confuse efforts to understand this complicated situation by endeavoring to explain such requirements.

I call to the attention of the new members of the committee that the beauty and barber industry, while large in numbers, is composed of many small, individually owned shops manned, in many cases, by only one person. Consider the plight of the small shop owner confronted with signing the frightening certificate of purchase for resale provided for by the regulation of the Internal Revenue Bureau. Not possessing legal talents, is it any wonder that many beauty- and barber-shop owners threw up their hands when they were confronted with the necessity of signing the frightening certificates and maintaining the records required by the Bureau's regulation and decided not to sell toiletries and cosmetics if it meant signing the certificate?

Because of the expert knowledge of the sciences of cosmetology and barbering and care of the hair and skin possessed by beauty- and barber-shop operators they are better equipped than the usual retail clerk in guiding customers in the use of toilet preparations and cosmetics, and beauty and barber shops should be the normal and natural outlets for sales of these items. However, campaigns by the industry's associations and trade publications to stimulate and increase retail selling by beauty and barber shops have been ineffective due to the resistance of shopowners to signing the frightening certificates of purchase for resale and the record-keeping requirements of the tax law. As a result, we have found there has been a decline in the number of shops retailing cosmetics. Recent Census Bureau figures show that of the 74,407 beauty shops reporting, 3,405, or less than 5 percent, stated that they sold toiletries and cosmetics at retail—and this showing for an establishment which is the natural and logical outlet for cosmetics distribution to the public.

Shops who have refrained from selling toiletries and cosmetics as a result of the harsh procedural requirements of the tax law have lost vitally needed income they would normally derive from such sales which they need to supplement their income from the services they render. A recent Census Bureau report states there are 8,574 fewer beauty shops and 26,005 fewer barber shops now than there were in 1939. Instead of growing the industry has shrunk in numbers of establishments. This can be traced to the procedural requirements of the present tax law. During a period of recession, there is a considerable falling off in the revenue shops receive from rendering services. Industry leaders realize that shops need the additional revenue they can obtain from retail sales to supplement their incomes from services if they are to survive.

The future economic health of beauty and barber shops depends on their ability to supplement their income from services with revenue from retail sales of cosmetics. Unless the industry is granted the tax relief provided for in section 482 (b) of H. R. 4473, the revenue Act of 1951, the deterrent to retail selling by shops will remain as long as shops are required to sign the obnoxious certificates and the industry will continue to be stunted in its growth.

Industry representatives have made tireless but futile efforts to have the Treasury Department eliminate the harsh certificate of purchase for resale through administrative action. They were told, in effect, that only congressional approval of legislation of the type provided for in section 482 (b) of the proposed Revenue Act of 1951 will eliminate the burdensome procedure imposed on beauty and barber shops.

We respectfully urge the Committee on Finance to grant beauty and barber shops the relief provided in section 482 (b) of H. R. 4473 from the harmful and burdensome procedure resulting from the tax on bulk cosmetics used in rendering services by maintaining in its proposed 1951 tax bill section 482 (b) of the Revenue Act of 1951. We repeat that our industry wants to pay its just share of the increased taxes needed to support the mobilization effort. However, we feel that the necessity of raising additional taxes must not be used as an excuse for continuing harsh and discriminatory excise taxes in a permanent tax structure.

Senator BYRD. In lieu of an appearance there will be inserted into the record at this point a statement from the National Sporting Goods Association by Mr. E. R. Vandervoort of Lansing, Mich.

(The document referred to follows:)

NATIONAL SPORTING GOODS ASSOCIATION,
Chicago, Ill., July 26, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR: The National Sporting Good Association, on behalf of its dealer members, appreciates this opportunity to present its views on the excise tax bill to your committee. Because of the time limitation on testimony, we would very much appreciate your placing this letter in the record of your committee hearings.

In March representatives of this association testified before the House Ways and Means Committee during their hearings on the excise tax bill.

We respectfully urged at that time that the excise tax on athletic equipment be removed, since the majority of these items are used by schools, which are are not subject to the tax as political subdivisions.

In our testimony, we pointed out that athletic equipment purchased by schools was subject to exemption, and that the effort involved in processing tax-exemption certificates placed a heavy, expensive burden on sporting-goods dealers throughout the country, and that the Government realized little or no revenue from this tax.

The complete removal of the 10-percent excise tax on such articles as golf clubs, golf balls, golf bags, tennis and badminton equipment, fishing tackle, guns and ammunition, and so forth was not requested by the National Sporting Goods Association in its testimony before the House committee, since the need of the Federal Government for additional revenue in the face of increasing budgets is realized.

As passed last month by the House of Representatives, H. R. 4473, section 488, repeals the excise tax on certain sporting goods, and increases from 10 to 15 percent the tax rate on other items.

We respectfully request that your committee recommend the removal of the excise tax on sporting goods and athletic equipment primarily used by schools and children.

However, H. R. 4473 failed to carry provisions for the removal of the excise tax on baseball equipment. Since this type of equipment is used mainly by schools, colleges, and youngsters throughout the Nation, the National Sporting Goods Association, speaking for sporting-goods dealers in the United States, requests that your committee favorably consider the removal of the excise tax on baseball equipment.

In pressing our request for the removal of excise taxes on certain articles of athletic equipment predominantly used for school sports and other articles predominantly used by children, we would like to present our reasons for this request.

Public schools and all tax-supported bodies can, under terms of the present law, claim exemption of the excise tax on athletic equipment. The National Sporting Goods Association has received a number of complaints from private and parochial schools in regard to the discriminatory nature of this provision of the law. Teams from private and parochial schools compete daily in athletic contests with public schools. They use the same equipment for the same purpose, yet one school is able to purchase the articles tax-free, while the other school must pay the excise tax.

The burden on sporting-goods dealers of executing tax-exemption certificates as required by the law on purchases by not only the Nation's 29,000 public high schools and 170,000 public grade schools, but also by boards of education, and city, park, and recreational departments, is oppressive.

Since the majority of these orders are for small quantities, the clerical expense incurred in the proper preparation of these exemption certificates is frequently larger than the amount of the allowed tax exemption.

The many small retailers in our association certainly cannot afford to absorb the tax allowance, and each claim must be processed as it is filed.

The expense of processing these tax-exemption certificates produces in most cases a considerable reduction in net profit. This reduction in profit, in turn, reduces the amount of income tax paid to the Federal Government.

The amount of the additional clerical expense required to process these exemption certificates is the exact amount of the income reduction of the individual sporting-goods dealer which would be subject to Federal income taxes.

Surveys made in Indiana recently have indicated that the cost to the average dealer of processing tax-exemption certificates on athletic equipment used by schools and other tax-supported institutions ranges from $1,000 to $5,000 a year, based on his volume of business.

When you multiply this figure by the approximately 4,000 athletic equipment retailers in the United States, the total minimum cost every year for dealers to process these certificates is $1 million. In addition, the athletic equipment manufacturers must bear a similar expense in administering these certificates.

A large loss in Federal income tax thus results from this considerable loss in profit and increase in expenses on the part of both sporting-goods dealers and manufacturers.

The National Sporting Goods Association would like to take this opportunity of emphasizing that the foregoing all concerns a tax which furnishes very little revenue to the Federal Government, since the majority of the tax is subject to exemption.

We further would appreciate your considering favorably our urgent request that H. R. 4473, as passed last month by the House of Representatives, be amended to maintain the present excise-tax rate on the remaining sporting-goods items at 10 percent, rather than the suggested rate of 15 percent.

In testifying in 1950 and 1951 before the House Ways and Means Committee, the National Sporting Goods Association did not recommend the removal of the excise tax on golf, tennis, and badminton equipment, fishing tackle, and guns and ammunition.

Since we are a small industry, we do not feel that the excise tax on these items can fairly be raised to 15 percent unless a general excise tax of this percentage is levied on other products.

In summary, we respectfully request the committee to:

1. Amend section 483 of H. R. 4473 to eliminate the excise tax on baseballs and baseball equipment, since such equipment is predominantly used by youngsters and in the Nation's school system.

2. Allow the excise tax on articles other than athletic equipment, listed in section 3406 (a) (1), 1941 Revenue Act, to remain at the present rate of 10 percent, rather than raising the rate to 15 percent as proposed in the bill passed by the House of Representatives.

Respectfully submitted,

NATIONAL SPORTING GOODS ASSOCIATION,
By E. R. VAN DEUSEN, *President.*
By G. MARVIN SHUTT, *Secretary.*

Senator BYRD. In lieu of appearance there will be inserted into the record a statement on behalf of Butler Bros.

(The document referred to follows:)

MEMORANDUM OF THE EFFECT PRODUCED BY THE EXCESS PROFITS TAX ACT OF 1950 ON BUTLER BROS., AN ILLINOIS CORPORATION

The purpose of this memorandum is to show that Butler Bros. improved earnings in 1950 and prospects for improved earnings in 1951 and beyond, relative to earnings during the years 1946-49 and relative to capital employed, are due principally to internal factors of management rather than to stimulation by the national defense program; that the application of the excess-profits tax rates to such improved earnings is inequitable and unjust, and contrary to the spirit of the Excess Profits Tax Act of 1950, and contrary to the intent of Congress in enacting that act; and that Butler Bros. is therefore justly entitled to equitable relief from such excess-profits tax.

THE COMPANY AND EARLY HISTORY

Butler Bros. is a national distributor of merchandise at wholesale. Its principal business is to service the merchandise needs of small independent merchants throughout the country. This is done through five large distributing warehouses, strategically located in Baltimore, Chicago, Minneapolis, St. Louis, and Dallas. It also services independent floor-covering retailers through branches in these five cities and New York City, Philadelphia, and San Francisco.

The company was organized in 1877 and incorporated in 1887. It had a good record of growth and earnings until the twenties, when growth stopped and earnings receded.

In the early thirties the company launched a program of cooperative development with privately owned small retail stores. These stores were franchised as distributor stores, or then called voluntary chain stores, under the names Ben Franklin (variety stores) and Federated (junior department stores). For various reasons, largely internal to the company, this program gathered momentum but slowly in the thirties and was seriously impeded during the war years, as mentioned later.

At about the same time, the company founded its own chain of retail stores through its subsidiary, The Scott-Burr Stores Corp. This subsidiary operates 164 retail variety and department stores throughout the country. It is a separate taxpayer with different operating and tax problems, and for that reason further reference to it is omitted from this memorandum.

It was intended that the techniques of successful retail-store operation tested by the company in its own stores would form a foundation of permanence for the independent retail merchants serviced by the company.

During the thirties the company developed and maintained at substantial cost to itself a large field organization to assist the small independent merchants to operate their franchised stores competitively and at satisfactory profit to themselves. This was done to foster their own growth, and to help them meet successfully the chain store competition that was then making its principal growth.

Through this means it was expected that a lasting cooperative relationship between the company and its independent merchant customers would be evolved. The expectation was that this would bear fruit sometime in the future in more sales, better customer relations, reduced selling and operating costs, and finally, in improved profits.

MORE RECENT DEVELOPMENTS

The so-called war years 1941-46 were a period of improved prosperity for the company (relative to its earnings of the thirties), as shown in the following tabulation from its tax returns (after agent's adjustments, with 000 omitted):

[000 omitted]

Year	Net sales	Taxable income	Rate of return on total assets
			Percent
1938	$67,075	$494	1.66
1939	71,551	1,301	3.94
1940	72,664	767	2.31
1941	94,320	3,060	9.10
1942	105,181	4,471	11.21
1943	105,437	3,751	9.17
1944	98,070	3,578	8.07
1945	101,078	4,714	10.45
1946	139,453	5,552	11.60

These same years, 1941-46, had a negative effect on the company's franchised-store program. They were characterized by a sellers' market. This, and the war-induced turbulence in business and national affairs generally, acted to alter the company's longer-range objectives. Aggressive competition and other factors normally present in the economic atmosphere did not operate in these years with their usual force to restrain business expansion and experimentation. Fed by the success of most new ventures at that time, expansion into new and different fields of endeavor became a dominant philosophy in the company's planning.

During the years 1941-46, and more particularly in the latter part of this period, the company expanded its interests to include manufacturing, a new type of franchised stores, new methods of operation, much wider selections of goods and price ranges, including entirely new lines of merchandise in which the company had little or no merchandising background, and other ventures not directly in the field of the company's experience.

Characteristically, the expansion into these new fields of endeavor added very greatly to the company's fixed and overhead costs. This expansion required substantial investment in merchandise lines and activities in which the company had no sales history or operating experience to guide it. Inventories and merchandise commitments necessarily were extended heavily, and by the end of 1946 had become badly unbalanced.

In this situation, the company was confronted early in 1947 with a return to more normal patterns of merchandise distribution throughout the country. Its inventory was unbalanced and greatly inflated. Much of it was in goods introduced during the war that had become unmarketable through its normal prewar channels. Its cost structure was greatly excessive in relation to its normally expectable volume. It had not established a competitive position in the newer fields it had invaded sufficient to develop and hold adequate sales volume to carry this cost burden.

The high operating costs and fixed expenses that stemmed from the expansion program just described, coupled with loss of volume and precipitous markdowns on merchandise, developed large losses beginning almost immediately in 1947.

New management was brought into the company about mid-1947 to stop these losses and to develop improved earning power. However, in the three following years 1947-49, the company showed taxable net losses of almost $5,500,000. Excluding a profit of $900,000 on the sale of real properties, the loss from operations during this 3-year period was nearly $6,500,000.

About the middle of 1949 the company's top management was changed again. With this change, substantially every one of the company's top executives had been replaced since mid-1947.

At this point in the company's history it was perfectly plain that immediate reversal of losses and an early and satisfactory return on investment was required, or that dissolution of the company was in prospect. The company simply could not survive the huge losses that were draining off its working capital—at a time when virtually all other businesses were earning peak profits.

A detailed and searching analysis was undertaken immediately by the company's management to determine if continued employment of the company's funds in the wholesale business was justified, or if immediate liquidation was necessary to prevent further dissipation of capital. This analysis penetrated the markets and customers served by the company, the items of merchandise carried, and the costs of distribution, profit opportunity, future growth possibilities, and economic permanence of wholesaling as a method of merchandise distribution in this country.

If it had not been so before, this analysis made it perfectly plain that general wholesaling on a national scale of a general line of merchandise to a general group of customers, such as the company had undertaken in past years, has no future.

It was equally plain that wholesaling, far from fading as was commonly believed, is virile and growing, and that there was and is a demonstrable need and an economically sound place for the wholesaler in this country's scheme of merchandise distribution.

Through this study a business formula was evolved that, in the judgment of the company's management and board of directors, would enable the company's management to stop the losses and develop an earning power relative to capital employed at least equal to the average of successful merchandising companies.

Consequently, late in 1949 the company's management launched a program of reorganization and concentration that still is proceeding. The effect of this program on the company's 1950 earnings, and its future potential earning power, is perhaps best described in the following paragraphs extracted from the statement of the company's president, Mr. B. R. Prall, to the shareholders at the annual meeting, April 26, 1951.

"Two years ago the question was asked persistently, by ourselves and by others who knew this company, as to why we continued in the wholesale business. Losses had mounted for 3 years and evidence was lacking of any real opportunity for profit and growth in wholesale.

"Without a clear answer to this question we could not formulate a sound program for the profitable employment of the company's capital. We, therefore, studied the wholesale maket exhaustively, and analyzed the opportunities for profit in that market for a company like ours.

"The evidence we gathered showed us that important changes had taken place in the character of wholesale distribution over a long period of years, and that Butler Bros. had not adjusted to these changes.

"It was perfectly plain that there was no longer an opportunity for satisfactory profit in a scheme of distribution that called for offering a general line of wholesale merchandise to a general list of customers on a national scale. In other words, the wholesale business as Butler Bros. had been accustomed to conduct it in past years had no future. We simply could not be as we had been—all things to all people—and earn a satisfactory profit.

"We had the choice then to reorganize our wholesale division promptly and completely to earn a satisfactory return on investment, or to withdraw from the wholesale business. This was a difficult choice to make, and one that called for real intestinal fortitude on the part of your management and board of directors.

"Our market analysis showed us clearly that wholesaling as such, far from being dead or dying, was a virile business with an economically sound place in the scheme of merchandise distribution.

"It retold us some vital things about our company that had become obscured—that Butler Bros. is a highly respected and valuable name in the trade; that we have a large body of franchised and other cooperative customers who look to us as a principal source of supply, and who buy in sufficient volume for satisfactory profit; that by concentrating on serving these customers and by eliminating the many fringe items and activities that had become ingrown, we could cut our merchandise lines and investment, and therefore our exposure to risk, in half; that by so doing we might temporarily lose sales volume, but would greatly improve our chance of profit.

"Most of all, this study told us that satisfactory profit in our kind of wholesale business required a two-fisted competitive capacity, with higher efficiency and much lower operating costs than anything the company had achieved up to that time.

"Careful and requiring analysis of the facts gathered convinced us that there was, and there is today, a quite satisfactory opportunity for profit and growth in our wholesale division. There remained the need to demonstrate that we in Butler Bros. could realize on that opportunity. If not, there could no longer be any possible justification for continuing the company in the wholesale business.

"In wholesale, therefore, we had two very pressing requirements. We had to stop the company's losses quickly, then hold the line long enough to prove what we believed was a formula for lasting profit and growth.

"As I told you at our last shareholders' meeting, we picked the Baltimore house as our testing ground. From the profit standpoint, this house had been our poorest operation with the most pressing need for corrective action. Pursuing the route indicated by our study, we reorganized this house to serve only franchised stores, and other variety merchants who look upon the company as a principal source of supply. We reduced the customer list by three-fourths. We reduced by two-thirds the number of different merchandise items stocked, the space used, the personnel employed, and the investment required.

"These moves cut Baltimore's 1950 sales nearly in half. But they made it possible for the house to earn the best profit return on investment of all operating divisions of the company. From being the poorest profit house, Baltimore evolved in 1 year into the best profit house, proportionate to sales and investment. The sharp sales declines that resulted from the 1950 curtailments have now given way to sales gains that in the 1951 first quarter greatly exceed any other house.

"Baltimore's results to date have proved to our satisfaction the formula for profit and growth in our wholesale division. This formula is now in operation in our Dallas house and is currently being installed in other locations. It requires simplified and economical warehouse operation, efficient utilization of space and manpower, shorter and highly competitive merchandise lines, serving fewer and better customers who will work fully with us on a cooperative basis.

"The evolution of this program has taken nearly 2 years and is not yet completed. In 1950, compared to 1948, total wholesale sales decreased by almost 28 percent. In the same period wholesale expenses were decreased by over 80 percent. On an annual basis this is an expense reduction of $7,834,000. It was accompanied by a markdown reduction of $3,250,000. Also in this period, wholesale customers were reduced from 27,000 to under 10,000 and merchandise items stocked from 80,000 to less than 15,000.

"On the other hand, the number of franchised stores served grew from 1,901 to 2,128 and the proportion of our company's wholesale business represented by these stores increased from 44 percent in 1948 to 60 percent in 1950."

It is normal and natural that the full effect of these improvements in the company's operations would not become evident immediately. However, it is important to proper appraisal of the company's situation under the Excess Profits Tax Act of 1950 to recognize that the steps taken and the results achieved in 1950, were almost entirely pre-Korea. This is especially true of the improvement in markdown and expense control, as shown in the following table (000 omitted). (The results for the years ended June 30, 1949, and June 30, 1950, are shown merely to emphasize the pre-Korea timing of these improvements.)

[000 omitted]

Year ended	Net sales	Markdowns		Operating expense		Taxable income	Percent of return on total assets
		Amount	Percent	Amount	Percent		
Dec. 31, 1946	$138,433	$2,042	1.5	$20,802	15.0	$5,552	11.60
Dec. 31, 1947	112,624	6,560	5.8	20,632	18.3	−5,445	−12.19
Dec. 31, 1948	126,949	4,297	3.4	19,846	15.6	−388	−.16
June 30, 1949 [1]	111,931	5,352	4.8	17,760	15.9	−1,425	−3.42
Dec. 31, 1949	96,715	3,270	3.4	15,003	15.5	345	1.14
June 30, 1950 [1]	90,978	1,686	1.9	12,618	13.9	2,228	5.90
Dec. 31, 1950 [1]	90,819	881	1.0	11,326	12.5	5,039	12.76

[1] Per books.

There is no doubt that general economic conditions in 1950 were favorable to the company's operations. However, they were almost equally favorable in 1947, 1948, and 1949, when the company's operations produced a pretax loss of nearly $6,500,000 for the 3 years.

The conclusion is logical and proper that the 1950 improvement in the company's earnings, and the anticipated future earnings improvement, have been due principally to factors internal to the company, and hardly at all to external economic factors stimulated by the Korean War.

APPLICATION OF THE EXCESS-PROFITS TAX

Based on the foregoing paragraphs, it is submitted that Butler Bros. has no normal pattern of past earnings that can be used as the basis of measuring excess profits for the purpose of equitable taxation within the spirit of the 1950 act.

Under the Excess Profits Tax Act of 1950 the efforts of the company's management and board of directors to restore the company's earning power sufficiently to permit it to remain in business, and to perform a neded service to independent retail merchants, will be penalized for their success.

The "average earnings" method of computing the excess-profits tax credit, based on earnings in the base period years 1946-49, is clearly inapplicable to the company.

The alternative offered by the Excess Profits Tax Act of 1950 of computing the excess-profits-tax credit by formula related to invested capital also is clearly inapplicable, and inequitable if applied to this company. The inequity of this formula in situations similar in principle to that of the company, as just described, was recognized by the tax draftsmen and by the Congress, and to a degree provided for in various relief provisions of the act.

Through consultation it appears that the act as written, and the regulations issued by the Commissioner of Internal Revenue, do not afford the company direct access to a suitable relief provision. It did not experience the substantial change in products or services apparently required by section 443 to apply for relief thereunder. There was no such increase in capacity or production as contemplated by section 444. It is not a new corporation as defined by section 445. The wholesale industry is not one of the depressed industries determined by the Secretary of the Treasury under the provisions of section 446. Relief sections 448, 449, 450, 453, 455 are specific industry relief provisions and as such inapplicable to the company. Section 442 (a) (1) does not apply and the World War II Excess Profits Tax Act decisions relating to the relief provided by section 442 (a) (2) indicate that by interpretation, this section does not apply to the circumstances in the company's experience.

The foreclosure of the company's access to suitable relief provisions of the Excess Profits Tax Act of 1950 imposes an unjust and inequitable tax burden on the company. This inequity should be remedied to give the company direct access to suitable relief provisions similar to those offered in section 442 (d) pertaining to abnormalities during base period, new corporation section 445 (b) or section 443 (b) (for changes in products or services) of the present act, if necessary by modification of the language of the act itself.

Senator BYRD. In lieu of appearance, there will be inserted into the record a statement from Mr. Arthur B. Hyman of the New York bar.

(The document referred to follows:)

MEMORANDUM TO THE SENATE FINANCE COMMITTEE ON THE NEED FOR REVISION OF THE INTERNAL REVENUE CODE

(Submitted by Arthur B. Hyman of the New York bar)

To the Senate Finance Committee:

We passed from emergency to crisis and back again, and it seems that we shall never have an opportunity to consider taxation in an atmosphere conducive to the creation of a sound system. Pressure, real or fancied, is in no small degree responsible for the crazy-quilt we call an Internal Revenue Code. The uncertainties which have been created by legislation in a field in which certainty should be the prime objective are appalling. The code, which no layman and few lawyers can read with any reasonable degree of understanding, and a judicial disregard of legal principles when taxation is involved, have created absolute chaos.

In connection with the consideration of the Revenue Act of 1948, we appeared before the Ways and Means Committee and orally and in a memorandum presented our views on this subject. We did not, in the oral presentation, have the opportunity to get very far beyond a discussion of the Dobson rule, which to the great relief of taxpayers, their counsel and the courts has been abrogated. Changes were also made in the "contemplation of death" provisions of the estate tax law. Much more progress is needed and it is not in the direction of "loophole" closing which Treasury officials emphasize ad nauseum. In the memorandum above referred to we pointed out a number of changes which appeared to us to merit consideration and which we shall discuss hereafter.

Responsibility for the maintenance of our great Government and our traditional way of life lies in the hands of those to whom leadership has been entrusted. The greatest danger that confronts us is not from without but from within. Profligate spending and overburdensome taxation are more deadly that the armed might of the Soviet. Thrift, which in past ages was not viewed with disfavor even in the conduct of public affairs, seems in this generation to represent an outworn philosophy. Money is spent with an abandon that would be terrifying to a people whose senses had not been dulled by habit. Unfortunately, they will not awaken until they find the foundations of their Government rocking from the impact of unsound fiscal policy.

In a democracy such as ours, we must have enlightened leadership. Warnings from men in positions of importance, business, finance and public administration have been sounded. Those who have been vested with the responsibility of managing the affairs of the bigest business on earth seem to have an idea that that business can be successfully managed and operated without regard to the principles which are vital to the perpetuation of any other business organization.

It is not difficult, of course, to understand the mental processes that lead to increased personnel in Government service, or to appropriations for projects which are unnecessary or which we cannot afford, but the time comes when we cannot indulge ourselves in such extravagances. If, unfortunately, we are called upon to make vast expenditures which we cannot with safety avoid, the most obvious action on the part of the administration would appear to be to curtail to the point of austerity all expenditures for other purposes.

Some 2 years ago a respected member of the Senate, in addressing a group of businessmen, remarked that the Congress could not make very much progress on the tax bill then under consideration until it knew how much money the Government intended to spend. We thought he had the cart before the horse, and expressed the view that the Congress should determine how much we can afford to spend and limit the administration accordingly.

Waste of public funds is an evil which we have become accustomed to, and concerning which we have been too complacent. We cannot afford the luxury any longer. The Congress is confronted with the necessity of raising fantastic sums of money by taxation. There are minimum requirements that must be met. There are economies of large proportions that can be effected in the operating expenses of the Government, and there are many things for which expenditures and appropriations are requested that either should never be granted or should be deferred.

The burden which our economy will have to bear in the coming year will probably not be alleviated in the very near future. Not a single dollar should be raised that is not of vital necessity.

Not only should the Congress concern itself with the financial burden that must necessarily be imposed upon us, it should also concern itself seriously with the manner in which it is imposed, and that subject requires a more extended discussion.

CAPITAL GAINS TAX

Whenever the occasion arises for consideration of a new tax bill, the subject of capital gains taxes obtrudes itself, and it will continue to be a subject of controversy until it receives more realistic treatment. It has been viewed primarily from a political standpoint and never upon its merits. Those who are for it look with disfavor upon the escape from taxation of a profit realized on the sale of property, disregarding the logic of the matter. They support their position by shouting "Wall Street," as if all such profits were realized by the bankers and brokers who operate in that maligned district. We are sure that they know that the capital gains tax affects all business transactions and, unless they are very ignorant, that trading in securities represents an activity indulged in by millions of our citizens. Something more than demagogic outpouring should be required to support the tax.

As long as a consideration of the subject is had in an atmosphere of pressure, it is perhaps too much to expect that a logical and practical view of it will be taken. This committee knows better than most, that the capital gains tax would be totally unproductive if it were imposed without distortion, that is to say, if gains and losses were treated with equal consideration, which they should be in the interests of principle and good conscience. On the other hand, the present method of treating capital gains and losses is harmful to the economy. Profits will not be taken if the consequence is a substantially smaller amount to reinvest in another capital asset. This is so even though good judgment suggests the propriety of taking a profit. Volume of trading is immeasurably reduced. Venture capital is restricted in movement from one field of enterprise to another. The taxpayer is frozen to his investment. These are statements of fact and not of argument.

Just as in business, a small margin of profit and a large turn-over are preferable to a large margin and a small turn-over, so it is through the whole economic system, and the rule applies as well to the Government which could enhance its revenue by encouraging capital transactions.

We can speak with some authority on this subject, for we are constantly being presented with the problem of whether property should be disposed of in the face of the attendant burdensome tax. An illustration points up the problem. A taxpayer recently bought 100 shares of Chicago, Rock Island & Pacific preferred at 47. It is quoted above 90 and is looked upon as a sound security. The taxpayer, however, would like to take the profit and switch into another security. For the privilege of doing that, however, he must pay a tax of over $1,000, and therefore if he should purchase 100 shares of another security it will have to advance more than 10 points before he is in the position he enjoyed before the sale; and the security he purchases may turn out not to be as good as the one he sold. The answer is that the taxpayer won't sell, and neither would you, and neither would we.

Multiply the illustration by the hundreds of thousands, perhaps millions, that are thwarted by a burdensome tax on profits and you will have some idea not only of its evil effect on the economy but of its failure to produce revenue in sufficient proportions to justify continued existence.

In our view, the capital gains tax should be eliminated from our system of taxation. There is no good in it, and if Great Britain and Canada can get along without it, we certainly can. However, realizing that the political courage necessary to bring about such an important change is not to be expected, we address our argument toward a better and more productive capital gains tax.

The Secretary of the Treasury has proposed an increase in the capital gains tax to 37½ percent. This is obviously a maneuver. He has too much intelligence to believe that an increase in the tax will increase the revenue. It is obvious, therefore, that his purpose is to forestall the arguments that will be made in support of the elimination or reduction of the tax. It is to be noted that he has sold the idea of an increase to the Ways and Means Committee. If he succeeds in the House or Senate in holding the tax to 25 percent he will have accomplished his purpose of preventing reduction and will have achieved a victory, but it will be a pyrrhic victory, for it will deprive the Government of increased revenues which can be achieved only by the reduction of the tax.

We have made an investigation of business done on the stock exchange during the last 25 years to ascertain whether our views have any support in the statistics. Apparently they have.

1925–33

In the period from 1925 to 1934 the volume of trades on the New York Stock Exchange was high. The capital gains rates were relatively low, that is, 12½ percent of the full amount of the gain.

1934–37

In 1934 the method of taxing capital gains was changed. That change remained in the law until January 1, 1938. Capital gains were taxed at regular normal and surtax rates but the percentage of capital gains which had to be included in income for tax purposes varied with the time that the asset was held.

An asset held for less than 1 year received no advantageous treatment. Eighty percent of the gain on an asset held for more than 1 year but less than 2 years was recognized; 60 percent of the gain on an asset held for more than 2 years but less than 5 years; 40 percent of the gain on an asset held for more than 5 years but less than 10 years; and 30 percent of the gain on an asset held for more than 10 years.

However, because the percentage of gain which had to be included was to be taxed at regular normal and surtax rates, the effective tax on capital gains was substantially increased. Thus, after January 1, 1934, in the case of a capital asset held for more than 2 years but less than 5 years, in which case 60 percent of the gain was recognized, effective normal and surtax rates went as high as 63 percent. For a taxpayer in that bracket the effective tax on such a capital gain would be 37.8 percent, or three times as much as it had been under prior law. Similarly, for a taxpayer in that surtax bracket who held a capital asset from 5 to 10 years, the effective tax on such gain would be 25.2 percent, or twice as much as theretofore. And in the case of a capital asset held more than 10 years, a taxpayer in the top bracket would have to pay an effective tax of 18.9 percent on the gain from the sale of such an asset.

In the case of taxpayer whose surtax net income was between $20,000 and 22,000, the total normal and surtax rate would be approximately 19 percent. For such a taxpayer who sold a capital asset held for more than 10 years, the effective tax on the gain was only 5.7 percent; for an asset held between 5 and 10 years the effective tax was 7.6 percent; for an asset held between 2 and 5 years the effective rate was 11.4 percent; for an asset held between 1 and 2 years the effective rate was 15.2 percent and for an asset held for 1 year or less the effective rate was 19 percent.

It can therefore be said that as a result of the Revenue Act of 1934 the effective tax on capital gains where income exceeded $40,000 per annum was very substantially increased.

It is therefore interesting to note that in 1934 the volume of trading on the New York Stock Exchange was slightly less than one-half of amount it had been in 1933 although personal income increased to $53,000,000 in 1934 from its low of $40,000,000 in 1933. Indeed the level of trading in 1933, 654,000,000 shares has never been reached since then.

The surtax rates were slightly increased in 1936 and remained constant until 1939. The increases affected only surtax net incomes exceeding $50,000, at which point the increase was only 1 percent and gradually rose until the increase totaled 16 percent on surtax net incomes exceeding $5,000,000.

In 1936 the volume of trading exceeded that for the previous year by 115,000,000 shares but the act did not become effective until the end of June. Volume declined to 409,000,000 shares in 1937.

1938–41

Effective January 1, 1938, the capital gains provisions were changed. Capital assets held for more than 18 months and less than 24 months were taxed by including 66⅔ percent of the gain in income and subjecting such gain to regular normal and surtax rates. Fifty percent of the gain on the sale of capital assets held for more than 24 months was recognized and subjected to regular normal and surtax rates. However, maximum effective tax on capital gains was set at 30 percent.

In 1938 the volume of trade declined 112,000,000 shares from the previous year and declined steadily thereafter until 1942. Personal income declined to $68,000,000 from $74,000,000 in 1937.

Between 1937 and 1940 there was no change in normal and surtax rates.

The Revenue Act of 1940 increased surtax rates on incomes between $8,000 and $100,000 per year, the maximum increase being 18 percent on surtax net incomes between approximately $50,000 and $60,000. In 1940 volume of trading decreased from 262,000,000 shares in the previous year to 207,000,000 shares.

In 1941 the surtax rates were again substantitally increased on surtax net income between $6,000 and $500,000. In that year the volume of trading declined to 170,000,000 shares.

1942 to present

In 1942 the capital-gains provisions were once again changed to provide that 50 percent of the gain on assets held for more than 6 months would be recognized and taxed at a maximum rate of 50 percent. In that same year, normal taxes were increased from 4 to 6 percent and surtax rates were once again substantitally increased. In 1942 the volume of trade reached its lowest level in the history of the stock exchange and declined to 125,000,000 shares. In 1942, personal income rose to $122,700,000,000, its highest point in over 12 years.

The capital-gains provisions have remained without change since 1942. The normal tax rate was decreased to 3 percent in 1944 and has remained at that point thereafter. However, the surtax rates were again substantitally increased in 1944. That year there was a slight decline (115,000,000 shares).

In 1945 surtax rates were decreased. In that year trading increased by 114,000,000 shares.

Though there have been no substantial changes in the capital-gains provision of the tax laws or the tax rates since 1945, the volume of trading has fluctuated between a high of 377,000,000 shares to a low of 253,000,000 shares in 1947.

Conclusion

As is indicated above, and as can be observed by examining table A ("Volume of trading in the New York Stock Exchange between 1925 and 1950") and table B ("Summary of the capital-gains provisions of the tax laws between 1921 and the present"), submitted herewith, an increase in the effective tax on capital gains usually was followed by a decrease in the volume of trading. The increase in the effective tax on capital gains has been brought about by either a change in the method of taxing capital gains (for instance, by taxing capital gains at regular rates rather than at one low set rate); by varying the percentage of gain which is recognized, depending on the holding period of the particular asset; by changing the regular normal and surtax rates; or by changing the maximum effective tax rate on capital gains.

These tables also lend support to the argument that a change in the holding period required for advantageous treatment of capital gains does not appear to affect the volume of trading very markedly.

During the same period covered by these figures the volume of all business in the United States has increased fantastically.

It is significant that trading on the exchanges has been relatively stagnant during the period of our greatest business expansion and of our highest personal incomes.

Of course, throughout the years the volume of trading has been substantially affected by other factors but we believe their impact was not comparable, if at all significant, to that of high taxes.

If there is any virtue at all in the views we have expressed, it would seem to follow that a very much lower rate of taxation on capital gains would produce a very much greater revenue, not only in that form of taxes but also in transfer taxes. We urge a 10-percent flat rate and the elimination of the element of time as a criterion of liability. A capital asset is a capital asset whether held for 1 day, 1 month, or 1 year. Today the profit realized on the sale of a capital asset is ordinary income; tomorrow it is a capital gain. Today it may be taxed perhaps at 75 percent of the profit realized; tomorrow at 25 percent. There just isn't any sense to it. The argument that profits earned in capital transactions during the first 6 months are speculative while those earned a day or two later are profits from investments is utterly untenable. The difference between speculation and investment cannot be determined by any such standard. Inherent in the act of every purchase is the hope of enhancement. If a substantial enhancement should take place within 6 months after purchase and is realized by a sale, the profit is no more to be placed in the speculative category than if it had been taken in the second, third, or tenth year.

If the low flat rate is unacceptable, we again propose the adoption of a method previously in use, that is, a descending rate of tax spread over a period of years. We suggest tentatively 15 percent during the first year of holding, 12½ percent during the second year, 10 percent during the third to the fifth years, inclusive, and 5 percent thereafter.

We urge the adoption of one or the other of the above suggestions, if only for the purpose of ascertaining the truth of the matter. Common sense tells us that such a procedure will open the channels of trade and vastly multiply transactions. Such an objective should be eagerly sought. But it is important also to know what effect it would have upon the revenue, and we will never know it until we make the experiment. We have everything to gain and nothing to lose, and if the result does not prove the soundness of the change, the problem of restoring the old rate is not insoluble.

It may be argued that a low rate of tax on capital gains will encourage speculation, but that is the very essence of our free-enterprise system. It permeates everything that we do. If those who fear it have in mind what we witnessed in the late twenties and early thirties, the answer is that we now have safeguards which will effectually prevent such a debacle. Large margin requirements will effectually serve to keep people out of the stock market who have no business in it. It is not a gambling room. It is a market place where legitimate business is transacted in the same way as it is transacted on real estate and commodity exchanges.

We make the foregoing recommendations for the purpose of bettering a bad situation. We do not wish to be understood as favoring a capital-gains tax in any form. Capital gains are not income despite judicial fiat to the contrary.

SALES TAX

Some years ago we urged the adoption of a system of taxation based primarily upon income and sales. Working in combination, these two methods, together with other regular and well-established sources, could be counted upon under all circumstances to raise whatever sums might be needed to finance the operations of the Federal Government. Having two primary methods of raising revenue, both of them reasonably flexible, would enable us to dispense with or reduce many other imposts, and under less necessitous circumstances renounce for the benefit of the States such sources of revenue as estates and gifts. Taxation at a reasonable rate on sales to ultimate consumers would be highly productive and easily administered. Another advantage from a fiscal standpoint would be constant flow of funds into the Treasury. No doubt some complications will be encountered as they always are, but they present no difficulty comparable to those experienced in the development of income and excess-profits taxation.

Proponents of the sales tax have always been and will continue to be met with the specious argument that such a tax imposes an inequitable burden upon those in the lower income brackets. The argument is really absurd. The man with ten times the income of another will, generally speaking, spend at least ten times as much as that other in the purchase of commodities subject to tax. In so doing, he will contribute at least ten times as much to the cost of Government. The assertion that the obligation to contribute toward the cost of Government should be based upon ability to pay is completely satisfied by the graduated levies on incomes, estates, and gifts.

The claim that the imposition of a general sales tax would meet with substantial resistance is certainly not valid. People are not so lacking in intelligence as to be unaware of the fact that they are paying a tax upon almost everything they buy and upon almost everything they do. Those in the lower brackets are being heavily taxed as a result of the imposts already laid. The general sales tax would, in fact, lighten their burden rather than increase it. It is foolish to pretend that the excise taxes are being paid only by those in the middle and upper brackets. Poor and rich alike are contributing vast sums in the form of excise taxes which are nothing more than sales taxes under different titles. In the last analysis too, the common sense of the American people can be counted up to appreciate and approve any system of taxation which is simple in operation and not discriminatory or oppressive.

In discussing the subject, one of the members of the House Ways and Means Committee predicted that we would shortly be faced wth the necessity of resorting to sales taxes to meet our needs. We were very close to its adoption not so long ago. Strong opposition was mustered against it, and an unwarranted fear of public reaction defeated it. We think that the people will now be for it and that the time is ripe for its enactment as a permanent part of our system.

The National Association of Manufacturers has come out in support of a substantial manufacturers' tax rather than a sales tax. We hope that this spirit of cooperation will not lead the committee to make a bad choice. Such a tax involves complications not present in a tax to the ultimate consumer. It would probably lead to pyramiding of prices, each manufacturer adding a bit, with the consumer an innocent victim. At the consumers' level, the tax can be added and collected separately just once. No tax of any character should be imposed up to that point. The consumer then knows the price of the article which he desires to purchase and what the tax will be.

The simplicity of collection would seem to be its best endorsement.

REVISIONS

In the memorandum submitted to the Ways and Means Committee in connection with the Revenue Act of 1948, we pleaded for taxation based upon fundamental principles of law, instead of in contravention of them. We inveighed against taxation by distortion. We asked that taxes be assessed upon the basis of reality and not speculation. Among other things, we suggested the following consistent pattern: The taxation of the income of trusts to the recipient of that income, without regard to whether the trust is revocable or irrevocable and regardless of the rights reserved concerning the future disposition of income; the imposition of gift taxes on transfers in trust, whether irrevocable or otherwise, and without regard to any reserved power to revest title in the donor or the settlor. It seems to us that it should be unnecessary to argue the propriety of taxing one who receives income from property conveyed rather than to attribute it to someone else in an unseemly pursuit of revenue, and had the opportunity presented itself before the errors were made, we do not doubt that such an argument, if made, would have prevailed. Under pressure of the Treasury Department, provisions were adopted without realization that we were paying a high price for a small achievement.

Trouble began when the Supreme Court evolved the conception that one might be in receipt of income through some moral or spiritual satisfaction. (See *Wells* v. *Commissioner*, 289 U. S. 670.) It increased with *Helvering* v. *Clifford*, 309 U. S. 331. We find no fault with that decision but a misunderstanding of its import led to an appalling raid by the Treasury Department on all of the taxpayers who had created trusts.

Clifford created a trust for a period of 5 years during which he retained practically complete control, and at the end of which the corpus reverted to him. In effect, the trust had no substance and the Supreme Court, for all practical purposes, treated it in that light. Any other view of that decision would impute to the Court a departure from the fundamental principle that when a settlor conveys legal title to trust property, the income being payable to another, whether it be for life or for a shorter period, he is parting with the ownership of the property and with the right to receive the income.

At the same session of the Court, it had for consideration the case of *Helvering* v. *Wood* (309 U. S. 344), in which a trust, similar in many respects to that involved in the Clifford case, was presented. In that case the Government relied upon section 166 of the Internal Revenue Code for authority to subject the income to taxation in the hands of the settlor. The Court held that it was not so taxable under that section and refused to permit the Government to switch its position and to attempt to include it under section 22. In that case it said that Congress had confined section 166 to trusts where there was a power to revest and that when the 1934 act was before the House Committee, the Congress rejected the recommendation of the Treasury that income from short-term trusts (of the character involved in both the Clifford and Wood cases) be taxable to the creator, but adopted its recommendation to tax him with the income of revocable trusts.

Note that in spite of the congressional adherence to principle, the Supreme Court found it possible to use the dragnet of section 22 to justify the impost in the Clifford case. Thus the trust in *Helvering* v. *Wood, supra*, if attacked under section 22 might have met the same fate as that in *Helvering* v. *Clifford* and this in spite of the Court's observation that the Congress had resused to subject it to a tax upon the recommendation of the Treasury Department.

So taxpayers who had drawn trust agreements over periods of years based on legal concepts which were supposed to have been well established (*May* v. *Heiner* (281 U. S. 238)) found themselves in quite a mess and in some cases they were absolutely powerless to protect themselves against judge made ex post facto law.

The limits of this memorandum do not permit an analysis of the cases that followed. They present a picture of the efforts of the Government to bring various trusts within the ambit of *Helvering* v. *Clifford* and of counsel for the taxpayers to escape its condemnation. We think the decisions in favor of the Government in practically all of the cases so decided were completely unjustified and resulted from a misconception of the decision in that case. However, what we wish to emphasize is that a tax law that is so uncertain in its application that a taxpayer unwittingly subjects himself to serious burdens, some of which he cannot escape by subsequent action, is intolerable and indefensible.

The discussion of the Clifford case points up another aspect of trust income. A distinction is made between a revocable and an irrevocable trust. We know that fundamentally the right of revocation reserved in the trust instrument is of no consequence unless it is exercised. Therefore, if the settlor creates a trust revocable only by him during his lifetime and he dies without having revoked the trust, every disposition made under it stands as if the right of revocation had never been contained in the instrument.

Many people have created trust agreements reserving that right not for any ulterior purpose but merely as an anchor to windward, that is to say, against the danger always existing, even though remote, of an economic disaster. The income under such a trust would legally belong to the beneficiaries. The legal principle governing the disposition of the income could not be stretched by the wildest imagination to tax that income to the settlor. However, it seemed heinous to the Commissioner of Internal Revenue, especially after tax rates began to take greater and greater sums out of the pockets of the people, that such income should be taxed at a lower rate than it would be if the settlor had retained it.

So the Congress was prevailed upon to adopt the indefensible scheme of taxing to the settlor income he had given away merely because he reserved the power to reclaim it at some time in the future; and yet so far as the disposition of the income was concerned it was not different in the case of the revocable trust than it would have been had the right of revocation not been reserved. We no longer concern ourselves with taxing people upon incomes received but spread the net to include incomes they might have received.

Under the head of revocable trusts, section 166 includes one where the power to revest in the grantor title to any part of the corpus of the trust, is vested in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom. Under that provision the word "substantial" has been held to have economic significance and that therefore a trustee or a number of trustees authorized to terminate a trust and revest the corpus in the grantor, have no such adverse interest. This view, we believe first enunciated in the Tax Court, was entirely unjustified since the trustees are under a legal obligation to the beneficiaries and accountable to them for mismanagement or for an improper termination of the trust, contrary to their interests.

Thus, though no right of revocation is reserved to the settlor, he is nevertheless taxable on the income from the trust though that income goes to others and he alone has no power to divert it. The trustees certainly have an adverse interest to the grantor even though it may not be a pecuniary one. That theory might have been demolished in the *Stuart* case (317 U. S. 154, *supra*). No doubt should be left upon that score.

We think that under the law of every State in the United States a trustee is accountable to the beneficiaries and that in that sense he has an interest adverse to the settlor. In order to clarify this section and to prevent any further litigation under it, we suggest that it be made clear, either by excepting the trustee from the category or by providing that the adverse interest need not be pecuniary. As a matter of fact, we think that if the Congress had intended a pecuniary interest it would have said so. Many considerations far more potent than personal pecuniary advantage might control the action not only of a trustee but of any other person in whom the right of termination might be vested. Certainly the parent of a beneficiary under a trust agreement would have a powerful motive for refusing to terminate a trust if vested with that power, although such parent might have no interest whatever in the corpus of income of the trust.

What we have said about revocable trusts applies in some respects to section 167. It taxes to the grantor such part of the income of a trust as:

"(a) (1) is, or in the discretion of the grantor or of any persons not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

"(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

"(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called charitable contribution deduction)."

Obviously if the income of the trust is or in the discretion of the grantor may be held or accumulated for future distribution to himself or be distributed to him currently or applied to premiums upon policies of insurance on his life, it should be taxed to him because such a trust would have no substance and would come within the condemnation which we think was the true intent of *Helvering v. Clifford*.

A different situation is created, however, when such disposition is subjected to the discretion of someone else. The purpose of this, as we have suggested in relation to revocable trusts, is to prevent the same result by prohibiting the use of a dummy and if it be made clear that an adverse interest need not be pecuniary but may be implied in the obligation to or interest in the welfare of others of the person in whom the power is vested, this section would be less objectionable. The fact that income may be diverted under certain circumstances to certain purposes, where the possibility is remote and has never become a reality, should not subject it to taxation in the hands of the grantor. It should be so subjected only in the years in which the possibility becomes reality.

No stronger argument on the subject could be offered than that furnished by subdivision (c), an amendment made by the Congress to except from the broad play of the statute the income of such a trust to the extent actually applied at the discretion of any person, the trustee or the grantor acting as trustee or cotrustee, to the support and maintenance of a dependent.

An inconsistency is to be noted here. It is not easy to perceive a distinction between the case of income which may be applied to the maintenance, education, and support of a dependent and the income that may be applied to the payment of insurance premiums. Yet the actuality is made the criterion in the one case and the possibility the criterion in the other.

This discussion must not be taken as a recommendation for revision or amendment of section 167 though it may be helpful if a broader objective is not attainable. We are sponsors for the basic principle that taxation should be founded upon established legal concepts and not upon their disregard and distortion. We propose the taxation of actual as distinguished from theoretical income and upon the one who receives it in fact; not through spiritual satisfaction.

Such procedure was once thought to involve a strong doubt of validity on constitutional grounds (*Lewellyn* v. *Frick*, 268 U. S. 238) and while that obstacle may have been removed by subsequent decisions there is no justification for the maintenance of such a system. We have no moral right to prevent the dispersion of one's income or principal and since we do not and cannot prevent the making of an absolute gift of the principal and a dispersion of the income in that manner there is not the slightest excuse for taxing to a settlor the income upon property which he has given away through the medium of a trust. The fact that the settlor retains the right to revoke the trust should have no bearing whatever upon the taxability of the income unless and until the right of revocation is exercised and the property or the income actually reverts to him.

In the same category we put taxation upon the settlor of income of a trust which he has established for the maintenance, support, and education of his minor children. If the parent is economically placed so that he is able to create a trust that will insure the maintenance, support, and education of his dependents and he is willing to isolate a sufficient part of his principal to accomplish this result, depriving himself of the enjoyment of it, why should we tax to him the income from it? Justification of this has been found in the theory that the income is being applied to the discharge of the settlor's legal obligations. That was the theory adopted by the Supreme Court in *Burnett* v. *Wells* (289 U. S. 670) and that is what we are inveighing against. It results not in the taxation of realized income which is the fundamental basis of such taxation but from a conception that one has no right to dispose of one's property as one sees fit because the Government thereby derives less revenue than it would have had he not made such disposition. It is said that such measures are for the protection of the revenue. Sound taxation will require no such measures.

In that category also are trusts created for the purpose of paying premiums on policies of insurance. Involved in such a trust is no legal obligation. We tax the income to the settlor because by means of the trust he satisfies a moral obligation. In other cases we tax him upon the theory of economic satisfaction—whatever that may mean.

In a recent case in the second circuit, *Commissioner* v. *Newman* (159 F. (2d) 848), the Court upheld a tax on income to the trustee of a trust made by his wife for the benefit of her minor children because he had the power to revoke, alter or amend, or to free any part of the principal and return it to the settlor. It is not clear whether the court's reason for such a decision was that it was a "family affair" such as was condemned in the Clifford case, or because it thought that it had possibilities for tax avoidance which it was its duty to circumvent. Judge Learned Hand's dissenting opinion is a defense of first principles. He said:

"Finally, if I understand the Commissioner, he wishes us to consider that these deeds may have been a preliminary step in a reprehensible scheme to lessen the wife's income taxes. There is not the faintest ground for imputing any such purpose to the parties at bar; and, if there were, it ought not to count. Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."

Applying the doctrines stemming from *Helvering* v. *Clifford* (309 U. S. 331), The United States Tax Court holds a wife taxable under section 22 (a) of the Internal Revenue Code on the income from a trust established by her husband for his life with the wife as sole trustee, having complete discretion to distribute the income to herself or her husband in accordance with their respective needs, regardless of how the income was distributed .

Judge Disney, dissenting for himself and five other judges, said:

"The majority opinion definitely goes much further than any case so far in extending taxation to one not the grantor of a trust. It was to just such cases as this, in my view, that the court, in *Kohnstamm* v. *Pedrick* (153 F. 2d, 506), referred when, commenting on extensions of *Helvering* v. *Clifford*, it said: '* * * The test is impalpable enough at best; but if it is to be continually refined by successive distinctions, each trifling in itself, we shall end in a morass from which there will be no escape; and the spate of decisions already poured upon us will be the earnest of eventual utter confusion'" (*Eleanor M. Funk*, 7 T. C. No. 102).

All these things emphasize the point that we have no reliable standard for the taxation of income. In a certain era we paid for not producing; we tax now for not receiving or retaining and the lengths that we have gone to are fantastic and many times shameful. It is not meet that a great government should raise revenue by methods which keep it constantly at war with its citizens and frequently subject it to scorn and contempt. Rather than to continue such a system let us, if necessary, raise the rates of taxation on the actual receipt of income. In order to accomplish this we must and should eliminate all provisions having as their objective the taxation to one of income which actually goes to another.

We take the same position in regard to gift and estate taxes. A gift tax is passed; the rate is fixed at approximately three-quarters of the estate tax, apparently for the purpose of encouraging the making of gifts, and then Congress could not resist the temptation of subjecting to estate taxes transfers which either were or might well have been taxed once and for all when they were made. What on earth is it that seems to make it impossible for us to pursue a simple, sensible course in such matters? Property in the hands of a decedent at the moment of his death should be taxed to his estate, and under no circumstances should there be included in that estate property which he has conveyed during his lifetime.

The imposing provisions of title III of the act of 1932 are as follows:

"(a) For the calendar year 1932 and each calendar year thereafter, a tax * * * shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

"(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *

"(c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or income therefrom * * *."

The tax applies whether the gift is in trust or otherwise, direct or indirect, with the exception of a transfer in trust where title to the property conveyed is vested in the donor alone or in conjunction with any other person not having a substantial adverse interest in the disposition of the property or the income therefrom. The exception ties the gift tax in with the tax on income from revocable trusts; that is to say, it takes out of the category of gifts those trusts in which the income is taxable to the donor or settlor and this at least was logical if not necessary. However, we repeat the observations made in connection with income tax on revocable trusts, namely, that a transfer of legal title with the benefits that naturally flow from it is a gift notwithstanding that the trust may some day be terminated. A gift in trust should be taxed as such whether it is revocable or irrevocable and the income from it should be taxed to the beneficiary as we have heretofore urged in our discussion of income from revocable trusts.

If the right of revocation is exercised and the property finds its way back into the hands of the settlor and there remains, it will be subjected to estate taxes at that time and provision can be made for whatever adjustments appear desirable. We also repeat what we said before in this connection, that is: that one making a gift in trust may have every intention of having the property irrevocably vest. Nevertheless, fear of economic reverses or of family eruptions may dictate the wisdom of not making an absolute gift at that time. He is quite willing to make a gift in trust and to pay the gift tax on it. Why should he not be encouraged to do that?

As a matter of fact when the act of 1932 was passed there was much talk to the point that the section would encourage gifts and thus increase the current revenue to the Government. It seems however that the preaching and the practice are at variance. Indeed this variance is emphasized in section 811 (*d*) of the code where it is provided that there shall be included in the gross estate of every decedent:

"(e) Any interest of which the decedent has at any time made a transfer, in trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power by the decedent alone or by the decedent in conjunction with any other person, to alter, amend, revoke, or terminate * * *."

The variance is further emphasized by the provision authorizing a credit for a portion of the gift taxes paid if the Commissioner subsequently determines that the money which he took for gift taxes was erroneously collected and that the property upon which the gift tax was paid should be included in the estate of the taxpayer.

The gift and estate tax provisions are said to be complementary to each other, that is to say: to create a logical whole. Under the Gift Tax Act however a transfer in trust of property under which the settlor receives the income for life is fully taxable if an irrevocable trust. There could be no possible argument that would serve to destroy the finality of the gift even though the life estate was reserved (*May* v. *Henier*, 281 U. S. 238, supra).

However, note the provisions of section 811 of the code which taxes as a transfer in contemplation of or to take effect at death, even so complete a transfer as that referred to "to the extent of any interest therein of which decedent has at any time made a transfer by trust or otherwise under which he has retained for his life * * * (1) the possession or enjoyment of or the right to the income from the property or the right, either alone or in conjunction with any other person, to designate the persons who shall posses or enjoy the property or the income therefrom."

Here we have an absolute transfer taxable as a gift under section 1000 and also taxable as a part of a decedent's estate at his death though obviously it did not pass by his death and he was absolutely powerless after the date of the establishment of the trust to alter its destiny.

It is to be observed that that section dealt originally with transfers made in contemplation of death and what in legal conception constituted contemplation of death was very well known to the legal profession. It was of some importance to the "protection of the revenue" that the tax which would be imposed upon the property of anyone passing at his death be not defeated by eleventh-hour transfers but the policy of attrition adopted by the Government in a short time placed the conception to which we have referred in a rather parlous position. It made an effort and it succeeded in many instances, to extend the theory to situations that some years ago would have met short shrift in our courts. Under its contentions and arguments any provision which had for its objective benefits to one's survivors bore that aspect.

To illustrate: Transfers in contemplation of death were deemed to be those made under the influence of imminent or at least near term dissolution. It was often argued that transfers made by people of advanced years were made in contemplation of death but this argument was almost universally rejected and such contemplation ascribed only to people in ill health or subject to conditions impelling them to prepare for it. In a most general sense, of course, everybody contemplates death but as it has been truly said, although remotely death is contemplated, transfers are often made in contemplation of life rather than death.

In the matter of *United States* v. *Wells* (283 U. S. 102) the court held that the words "contemplation of death" meant in relation to taxable transfers, that the thought of death is the imminent cause of the transfer. From certain language in the case, the idea crystallized that the word "motive" best defined the criterion. It was held that the motive to escape or reduce taxes that would otherwise be payable at death made the transfer includable in the estate. With this as a criterion, it will readily be perceived that most any transfer made during life can, by a slight stretch of imagination, be brought within the category.

In the *Estate of Paul Garrett* (8 T. C. No. 59, the decedent, in November of 1923, created a trust consisting of life insurance policies and income producing securities, the income of which was to be used for the maintenance of the life insurance policies. He died in 1940, nearly 17 years after the creation of the trust. The insurance policies and the securities from the income of which the premiums were paid, were held to be includible in the gross estate. There is a strong dissenting opinion which it is unnecessary to discuss but it is clear that Garrett did not create the trust in contemplation of death in the sense generally understood. Anyone at any age distributing property to his children might be said to be doing so in contemplation of death since he is giving it to them during his lifetime rather than waiting for dissolution.

These various sections have filled the courts with endless litigation in which fine-spun distinctions are drawn including one as farfetched as that property given away in trust is to be included in the estate of a donor if he had even the possibility of a reverter (*Helvering* v. *Hallock*, 309 U. S. 106). The authority of that case should not have lasted any longer than it took Congress to take note of it but it still stands. The Supreme Court sidestepped the doctrine of stare decisis and disregarded fundamental principles governing trusts and trust property in order to subject the property to taxation. Here again we have taxation by what we have previously called judge made ex post facto law.

In a recent case the court of appeals found it necessary to reverse a decision based upon *Helvering* v. *Hallock* where the possibility was so remote as to be about a thousand-to-one shot in any man's book (*Commissioner* v. *Estate of Singer*, C. C. A. 2, 161 F. 2d 15).

According to Mark Twain, when Eve presented Adam with an apple from the Tree of Knowledge, he said it was against his principles to eat it but he had found out that principles were of no force unless one is well fed, and he was hungry. We have about reached the same stage, that is: where principles are of no force when the tax collector calls.

At a time when we had no gift tax there was some justification for the inclusion in the estate of a decedent of property which he had transferred in contemplation of death. But contemplation of death meant something far different at the time of the adoption of those provisions than it means today. In the act of 1948, the Congress did something helpful by the amendment which excluded from the category transfers made more than 3 years prior to death, but that was only a half measure or less than that. As long as we have a gift tax, we do not need to include in the estate of a decedent transfers of any kind, even though made in contemplation of death. What purpose can possibly be served by involving the Government and its citizens in never-ending litigation on this subject?

What is the purpose of the gift tax? Obviously to implement the estate tax in such a manner that property, which is no longer in the estate of decedent because of transfers made during his lifetime, does not escape the burden of the tax. Why the "ifs" and the "ands" and the "buts"? If the Congress is not satisfied with the rate of tax on gifts, raise the rate to a parity with estate taxes. We are sure such action would deter the making of gifts, but it serves the purpose of preventing the loss of revenue, which the Congress was prepared to accept when it fixed the rate of tax on gifts. On the other hand, if Congress desires to encourage the making of gifts so that revenues can be presently realized, tax the gift when it is made, no matter in what form made that is to say without regard to revocability or reserved income or powers of diversion. If the property finds its way back into the estate of the settlor, it will become taxable at death, and provision should be made for a proper credit for the tax already paid. It would thus be unnecessary to tax to an estate property that was not in it at the time of death. With this change there will be eliminated also provisions dealing with contributions from donees.

. If we maintain a differential between gift and estate taxes, which has obvious advantages, the elimination of the contemplation of death provisions would make possible eleventh-hour gifts at the lower rate of tax. Consideration should therefore be given to the choice of equalizing gift and estate taxes in such instances.

If neither of these alternatives is acceptable, then by all means return to the conception of gifts made in contemplation of death before it became distorted by the pressure from a crusading tax collector, aided and abetted by a complacent judiciary, and include in the estate of a decedent only property transferred in the belief in imminent or near term dissolution. To implement this, provision should be made reducing to one year the period during which transfers are presumed to be made in contemplation of death.

We have suggested that all transfers, whether in trust or otherwise and whether revocable or irrevocable, be taxed; that all such transfers be excluded from the estate of the settlor or donor at death. In order words, let property that actually passes a death be taxed to the estate, not property that is included in the estate only through legal acrobatics and distortions. This of course has the disadvantage of simplicity which seems to be abhorrent but it accords with fundamentals which every person can understand, that is: that property belonging to a decedent at the time of his death is taxable as such and that which he has parted with in life is taxable under the provisions of the Gift Tax Act. Let us not be concerned in taxation with the fact that it might have come back to him but with the reality whether it did or not.

It is difficult in the present state of the law to determine what the real purpose of Congress was, that is: whether it desired to encourage gifts inter vivos and current revenue, or to discourage them so that larger revenues might ultimately be obtained through estate taxes. If the former objective is more desirable, we can achieve the results through the suggestions we have made. Certainly by their adoption, we shall create a sound pattern, thoroughly simple in its embraces and easily understood by all who are concerned.

BASIS FOR GAIN OR LOSS

We call attention to the inequitable treatment of gain or loss realized in the case of property acquired by gift inter vivos in contrast to acquisition by death. In the former cases the basis is declared to be the same as it would be in the hands of the donor or of the last preceding owner by whom it was not acquired by gift. In the latter it is the fair market value at the time of the acquisition.

In view of the fact that a transfer by gift is taxable in the same manner and upon the same theory as a transfer by death, there would seem to be no sound basis for the differentiation. It is not resolved by the fact that the tax on the transfer by gift is somewhat less than upon death. The property comes into the hands of the recipient in precisely the same way in both cases. The increment which accrues in the hands of him from whom the transfer emanated, has been subjected to the burden provided by law. The basis for determination of gain or loss should be the value of the property at the time of the transfer in both cases. We think the failure to treat both alike must have arisen from the fact that for considerable periods during the incidence of the Estate Tax Act there was no impost on transfer of property by gift. This inequity should be eradicated in the manner suggested.

WASH SALES

The present act as well as others that preceded it, provide for the exclusion of losses on the sale of securities in all cases where within a period of 30 days before or after the sale or disposition of such securities the taxpayer had acquired or has entered into a contract to acquire substantially similar stock or securities. We earnestly recommend the elimination of this provision. It represents another of the numerous efforts which the Internal Revenue Code reflects to distort the effect of perfecty normal transactions.

A gain or loss results from the sale or other disposition of a capital asset. Once such disposition is made, the gain or loss automatically results. One is not permitted to take the loss until then. We cannot understand why one should not be permitted to take the ordinary means available, and indeed required, for the establishment of a loss, nor why in order to establish it he must of necessity give up his position in a security, depressed at the moment but in the future value of which he has confidence.

Repurchasing it merely places him in a position where upon a future disposition of the security he uses the lower basis, that is, the repurchase price, for the purpose of determining future gain or loss. Such proceeding is permitted in the case of gains. By this operation the Government is not injured. On the other hand, the provision is utterly futile as a means to the end apparently desired for a taxpayer may accomplish the same result by simultaneous purchase of other securities. Thus all that the Government accomplishes is to drive him out of his position in the security which he preferred. What possible advantage this is to the Government is quite beyond our perception. Since he is permitted to realize gains, despite immediate repurchase, he should likewise be permitted to establish losses in the same manner.

The present act goes much beyond this. It denies the loss from sales or exchanges of property, directly or indirectly, between members of a family.

When the proposed extension of the restriction on wash sales was before the committee, it said:

"Many instances have been brought to light where transactions have taken place for the sole purpose of taking a loss for income-tax purposes. It is believed that the recommendation of the subcommittee if followed will effectually close this opportunity for tax avoidance. Experience shows that the practice of creating losses through transactions between members of a family and close corporations has been frequently utilized for avoiding the income tax. It is believed that the proposed change will operate to close this loophole of tax avoidance" (H. Rept. 704, 73d Cong., 2d sess., p. 23).

Was there really any loophole that needed to be closed? In order to take a loss a sale had to be made. Having the loss on paper, one has the right to take the action necessary to its realization. What earthly difference does it make to the Government or to the revenue whether Mrs. Jones purchases a security which Mr. Jones had held or it is purchased by someone else?

Under the laws of practically every State in the United States, husband and wife are free to contract in all respects, to own, hold, and dispose of property as if they were single. Why should this conception be distorted because taxation is involved? These distortions have been our besetting sin from the very beginning.

We do not doubt that Congress intended by the extension of the restriction to cover interfamily transactions as such and until recently purchase through the stock exchange of securities of the same corporations sold through the stock exchange by a spouse of the purchaser, was not held to be within the condemnation of this provision.

However, in recent cases of *Commissioner* v. *August Kohn* (158 Fed. (2d) 32, 4th circuit) and *Commissioner* v. *McWilliams* (158 Fed. (2d) 637, 6th circuit) the court of appeals reversing the United States Tax Court construed the word "indirectly" to cover such a transaction. In other words, that such separate purchase and sale constitute a sale between members of a family.

Certiorari was granted in the McWilliams case and the Supreme Court has affirmed.

Once again we are brought face to face with the uncertainties in which our taxpayers have become enmeshed. Normal transactions on the stock exchanges not in terms falling within the restrictions of section 24 (b) are held to be within it by construction. A taxpayer indulging in the approved method of establishing a loss and confronted with the advisability of doing so to offset gains, finds himself again the victim of taxation by judicial decree rather than by statute, at least by statute which is not susceptible of misunderstanding.

We urge the Congress to eliminate the entire provision dealing with family relationships but if that suggestion is not acceptable, to make it clear that transactions conducted in the normal course of business through the market places are not within the ban.

Notice should also be taken of the consequences of the decision of the Supreme Court. When the decision of the court of appeals came down, we inquired of the Bureau of Internal Revenue what basis would be attributed to the securities in the hands of the purchasing spouse since the statute made no provision for it. The Bureau declined to take a position. Thus the loss actually sustained by the selling spouse will have no recognition since there is no provision that the basis of the stock in the hands of the selling spouse shall be the same as in the hands of the purchasing spouse and we doubt seriously whether the Bureau is authorized to take any different position on the subject.

Should neither suggestion be acceptable, it will obviously be necessary to provide that in cases where such losses are not recognized, the stock shall retain the same basis as it had in the hands of the selling spouse. The very necessity of doing this forcibly demonstrates the artificiality of the whole business. If transactions were given their normal implications and taxation based upon them, we would have no occasion for such controversies and our citizens would not be continually victimized.

SECTION 45

While on the subject of so-called loopholes, we desire to direct the attention of the committee to section 45, Internal Revenue Code, because it points up what we have said about having tax laws that are definite and certain and leave no room for doubt concerning the liabilities that are imposed. Taxation should be by law and not by man. In section 45 that theory is more or less demolished.

It vests in the Commissioner of Internal Revenue power and authority in case of two or more organizations, trades or business (whether or not incorporated, whether or not organized in the United States and whether or not affiliated, owned, or controlled, directly or indirectly, by the same interests), to distribute, apportion, or allocate gross income; deductions, credits, or allowances between or among them if he determines that such action is necessary to prevent evasion of taxes or clearly to reflect the income of any of them.

Under that provision the sky is the limit and liabilities are at the whim and caprice of an administrative officer. We must have a yardstick for taxation. We have adequate provisions to cover fraud and other unlawful practices. Provisions of such character are the result of a misconception of the relations of government and its citizens. They are evidence of a trend away from our conception of those relations and a tendency toward despotism.

It is to be noted that the section does not establish any rules of practice or condemn intercompany business transactions of particular character but vests in the Commissioner of Internal Revenue unlimited and unrestricted power to increase the liability of the various affiliated businesses in such manner as he may see fit. It is all left to his determination and the committee will appreciate that that determination will be final unless entirely arbitrary.

Such an allocation was made by the Commissioner in Southern College of Optometry, Inc., Prentice Hall, T. C. Memorandum, Decision 47,070, Docket 10,556, and was disallowed in that case. Nothing short of the most flagrant abuse by the Commissioner of his power will entitle the taxpayer to relief and he will be exercising his power and authority whenever the notion strikes him. Our taxpayers ought not be asked to rely on his good judgment and discretion for determination of their liabilities. We urge that this section 45 be repealed.

SECTION 102

It will be noted that throughout this memorandum we have emphasized the importance of simplicity and of a system of taxation logical in all its impositions and faithful to fundamental principles. Punishment for violations of our laws is proper; punitive taxation has no justification and is abhorrent.

An example of this is to be found in section 102. Not only is it wholly punitive but the crime for which the punishment is inflicted is not and perhaps cannot be defined in terms so certain that the taxpayer may be conscious beforehand of its commission. That section provides for the imposition (in addition to all other taxes imposed by the act) of a penalty equal to the sum of 27½ percent of the amount of undistributed net income not in excess of $100,000, plus 38½ percent of the undistributed net income in excess of $100,000. That penalty is imposed on "every corporation other than personal holding companies if formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders * * * through the medium of permitting earnings or profits to accumulate instead of being divided or distributed." It is then provided that the "fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary." Let every man be adjudged guilty unless his innocence is clearly proven. Nice going for Government but not quite in accord with American tradition.

Nowhere in the Penal Code will there be found a crime made so by the determination of the judiciary, yet this is as much a penal statute, indeed more so, than one which imposes a fine for failure to file a return or for filing a false and fraudulent return. It must be borne in mind that this statute is not confined in its operation to investment companies. It embraces ordinary business corporations and it challenges them, at their peril, to retain their earnings or any substantial part of them for insurance of their stability and the expansion of their business.

The statute creates a presumption against them based upon the accumulation of profits beyond the reasonable needs of the business but what are the reasonable needs of a business and who is the best judge of them? Those questions are not left for them to determine. Honest and sincere though the executives of those corporations may be, it avails them nothing. A judge sitting in the Tax Court who may know as little about their business as a pig knows about Sunday, determines those questions for them and the statute pulls the props from under them by imposing upon them the obligation to satisfy the judge by a clear preponderance of the evidence that the purpose was not to avoid a surtax on the shareholders.

Suppose A, B, and C organize a corporation for the purpose of conducting a retail business. They start with a capital of $150,000 and one store. At the end of their first fiscal year they have gained $50,000 on which appropriate taxes have been paid. Obviously their purpose in embarking on the venture was to make profits and to reinvest them for the purpose of making additional profits. They hope to have other stores. We presume there is no objection to that. The economic wealth of this country has been achieved through the pyramiding of earnings which have been plowed back year after year for the upbuilding, expansion and security of business. This has always been one of the primary objectives of our economy. It is not assisted by compulsory distribution of earnings. On the contrary, our efforts in that direction are thereby frustrated.

We suppose it is not the purpose of a taxing statute to compel the relinquishment of the corporate form of transacting business but that is precisely what the statute accomplishes regardless of its purpose, that is: It induces the adoption of the partnership form of business though the corporate form would be far more desirable and much more advisable from all other standpoints. Furthermore it has led to an epidemic of corporate dissolutions with great resultant expense to taxpayers.

Not the least of the evils of such legislation is that its victims are small-business men operating in corporate form. It is absolutely powerless against big business indeed it is aimed directly at the small one. Taxation based upon ability to convince a judge of one's integrity of purpose partakes of the nature of trial by ordeal.

The statute is vicious. Its purpose is to force the declaration of dividends. It is not a commendable way to raise revenue and we have no right to resort to such methods unless they are absolutely necessary for that purpose. The fact that the section has been held constitutional as a means of "protecting the revenue" certainly is not justification for its enactment. The phrase is very convenient but in this setting it carries no conviction. The declaration of dividends is a matter within the sound discretion of the board of directors of a corporation. Neither the stockholders nor the Government can compel distribution. It is a contradiction in terms to say that a measure is for the protection of the revenue when such revenue accrues only by force of the so-called protective measure. It does not protect revenue. It creates it and does so by blackmail.

It would be well to look at the genesis of this section. In early days of income taxes corporations were taxed on their earnings, as they are now, but dividends in the hands of the shareholders were exempt upon the very proper theory that the same dollar should not be taxed twice. As long as this sound view of the matter prevailed there was no need for section 102 but under the pressure of need, the Congress closed its eyes to the inequity of double taxation on corporate earnings. With the removal of the exemption, the temptation to withhold the declaration of dividends was apparent.

If the Congress hearkens to the overwhelming demand for the restoration of the exemption, section 102 will go with it. Whether the exemption stays or falls, section 102 should be repealed.

ALLOCATION OF INCOME

Section 107 deals with earnings and permits a taxpayer to spread over the years in which services are rendered the amount received in one year, provided the amount received in that year is at least 80 percent of the total compensation for the services involved. We recommend that this section be liberalized to include interest and dividends which have been in default for a period of years.

It is tragic enough for those who are dependent upon such income to have been deprived of it through adverse conditions affecting corporations whose securities they hold. It is doubly so to be compelled to pay a rate perhaps two or three times greater upon receipt of this accumulated income than if it had been received ratably over the period. We think persons in that category deserve consideration and that the section should be liberalized to include them.

CORPORATE LIQUIDATIONS AND SALE OF ASSETS BY STOCKHOLDERS

This is an appropriate time to call attention to another example of taxation by judicial decree which ignores the legal standards by which such matters should be judged. We refer to those cases in which corporations have liquidated, distributed their assets to their stockholders, or to trustees for the stockholders, who in turn have sold the same to a purchaser. Some years ago the Treasury Departmentment took occasion to point out to the taxpayers at large that by this means double taxation could be avoided; that is to say, the tax upon the sale of the assets by the corporation and upon the distribution to the stockholders. However, not so long afterward the Commission proposed a deficiency in the tax upon a corporation where such a transaction was involved. It was sufficient for him that such a sale was in contemplation, or that negotiations had been opened for such a sale by the corporation before the liquidation took place, and that being sufficient for the Commissioner, it was also sufficient for the Tax Court and the appellate courts.

It was eminently proper for the stockholders to have liquidated, and as receivers of the assets to have entered into a contract for their sale, and thus to avoid having the same transaction taxed twice. The legal status of those steps is perfectly clear. Upon liquidation the stockholders became the legal owners of its assets and they alone had the right to enter into a contract for their sale at the time the contract was entered into, and they alone could convey the title, and theirs were the proceeds of the sale. Here we have the tax assessed upon a corporation and again upon the stockholders because they adopted normal legal means of avoiding that very thing, a course which had been recommended to them by the Bureau of Internal Revenue.

Many cases of similar character have received the attention of the courts. A reference to two of them will be enlightening. In *Acampo Winery & Distilleries, Inc.*, v. *Com. V. R.*, (7 T. C., No. 75) the Tax Court declined to sustain the Commissioner proposing to assess a tax against the corporation upon a sale by its stockholders of assets distributed to them in liquidation. The court held that the sale was by the stockholders and not by them in behalf of or as a step in a corporate transaction.

In *Wichita Terminal Elevator Co.*, (6 T. C. 1158), a tax against the corporation upon a sale by stockholders was upheld and the decision of the Tax Court sustained by a 2-to-1 decision of the Circuit Court of Appeals for the Tenth Circuit. (May 12, 1947, C. C. A., par. 9253.) The feature distinguishing the two cases is simply that in the latter case negotiations were first initiated by the president of the company prior to dissolution and transfer of its assets to a trustee in liquidation and his sale of the assets on behalf of the stockholders. Upon so small a distinction does tax liability, or worse yet, double tax liability, rest.

The language of the prevailing opinion forcefully reflects the attitude which puts taxation in the realm of the lottery:

"The transaction as a whole was cast in the form of conveyances of the properties of the corporation to Powell, as a liquidating dividend, dissolution of the corporation, and conveyances of the properties to the ultimate purchaser. The formal documents were molded in that pattern. The naked legal title passed from the corporation to Powell, and from Powell to the ultimate purchaser. And Powell was designated or referred to as agent for the former stockholders of the corporation. But in a case of this kind involving questions of liability for income taxes, the form of the transaction is not necessarily conclusive. The formal written documents are not always inflexibly binding. *Helvering* v. *Lazarus & Co.* (308 U. S. 252) (39-2 U. S. T. C., par. 9793). *Income taxes cannot be avoided by methods, devices, anticipatory arrangements, or contracts which merely give ill-founded complexion to the reality of a transaction in its relation to tax liability. Lucas* v. *Earl* (281 U. S. 111) (2 U. S. T. C., par. 496). *Griffiths* v. *Commissioner* (308 U. S. 355) (40-1 U. S. T. C. par. 9123). (Italics supplied.)

"The corporation was effectively dissolved for ordinary purposes under State law. And in some instances a corporation may distribute its assets among its shareholders as a liquidating dividend and not be subject to income tax on the gain when the property is subsequently sold by the former stockholders. *Commissioner* v. *Falcon Co.* (127 Fed. (2d) 277) (42-1 U. S. T. C., par 9403). But in determining the question of tax liability, a transaction of that kind should be scrutinized with care. *Tazewell Electric Light & Power Co.* v. *Strother* (84 Fed. (2d) 327) (36-2 U. S. T. C., par. 9351)."

Here is the challenge. It is unmistakable and unavoidable. Are we to adhere to the principle enunciated by Judge Holmes and oft repeated that one not only has the privilege but the duty as well to reduce or avoid taxes, so long as the means adopted are lawful or repudiate it for one that offers nothing but uncertainty and injustice from the tax standpoint? It is no answer to say that uncertainty and injustice are possible in all litigation, for in taxation the goal should be to set standards which make the results of any transaction reasonably certain and the avoidance of the necessity of resort to the courts for definition and determination.

The position of the taxpayer is precarious indeed that rests upon such flimsy differentiations of like situations. The sale in each was made by the stockholders. In each they dissolved their corporations and took over their assets in liquidation in order to avoid double taxation. Their methods were in accordance with legal procedure and effective for their purposes. They had the right to do precisely what they did. And the difference in their liabilities turned upon the dogmatic determination of the Commissioner, the assumption of its correctness by the Tax Court and the assumption of the Tax Court's infallibility by the circuit court of appeals under the drive of the Dobson case.

Taxation of income is beyond doubt one of the soundest methods for raising revenue. We thought when we amended the Constitution to permit it that it was also one of the simplest forms of taxation. The Supreme Court gave us reassurance when it defined capital as the tree, and income the fruit thereof. What has since evolved from this simple conception is a complete distortion of the system we set out to establish which has well-nigh destroyed the good that was inherent in it. No method of taxation can be sound in which the liability of the taxpayer rests upon judicial determinations rather than legislative standards. We must quit giving lip service to the conception that a man has a right to channel his transactions in such manner as to avoid or reduce his taxes so long as he does so by means which the law allows and then tax him as if by so doing he had been guilty of an offense called tax avoidance.

EXEMPTION OF INSURANCE FROM CLAIMS FOR TAXES

Enlightened States consider the claims of widows and orphans to be paramount to those of all creditors. We believe a large majority, if not all of the States of the United States exempt from the claims of creditors and seizure by them or by their representatives, of the cash surrender value and the proceeds of life-insurance policies. The Government of the United States has failed to join them in this highly desirable and benevolent policy. While it has recognized the propriety of the exemption in the bankruptcy statutes it has failed to extend this recognition to process for the collection of taxes.

Man's first obligation is the protection of his family. The primary means, and in many cases the only means available, is through life insurance. It should be and has been made generally throughout the United States untouchable except for those for whose benefit it is intended. The Government of the United States reserves the right for the "protection of the revenue" to destroy wholly and completely the protection of the family and to make public charges of the wife and children of decedent tax debtors, for the United States is not bound by the exemptions contained in the State statutes.

Our position in this respect is a reflection upon our morality. We should provide for recognition of the exemptions granted by the laws of the State of residence of the taxpayer or, if deemed more desirable, adopt a Federal statute granting uniform exemption to all taxpayers. It is unseemly for the Government of the United States to seize for the satisfaction of its debts, assets which have been made immune by the States even to their own obligations.

PROCESS OF GARNISHMENT

In most States of the United States debts may be satisfied by levies upon salaries and wages through the process known as garnishment. The levies, however, are in most cases limited to 10 percent of the salary of the debtor. Two considerations are implicit in this procedure. One that the salary or wage earner must be permitted to retain the proceeds of his labor or else become a public charge and if he is a man of family carry the members of that family with him. Furthermore he would have no reason to continue at work if his entire compensation could be applied to the payment of a debt.

These fundamental considerations have not yet been adopted by the Federal Government. It alone claims the right to take the entire salary or compensation of a wage earner in satisfaction of a claim for taxes. In practice, the collectors refrain from doing this but since the Federal Government holds itself beyond the pale of State exemptions and restrictions, the power is there and it has been used upon occasion.

We do not think this is an arguable matter. The mere presentation of the situation, it seems to us, should be sufficient to call for recognition in regard to garnishment of the rules that prevail in the State of a taxpayer's residence.

DISCHARGE OF TAX LIABILITY IN BANKRUPTCY

One next suggestion is that liability for taxes be made dischargeable in bankruptcy. The Bankruptcy Act is designed for the rehabilitation of debtors. Freedom from debt is accorded in consideration of the surrender by the bankrupt of his property for distribution to his creditors. The United States is entitled to preference above all others in such distributions. Nevertheless, although he has delivered up all his possessions, he cannot free himself from the claim of the sovereign. The very purpose of the Bankruptcy Act is thwarted by the failure of Congress to subject liability for taxes to discharge in the same manner as all other debts, for discharge in bankruptcy is of no avail to a debtor if he must remain subject to the most onerous debt of all. The right to preference on distribution is all that the United States should demand. Exception, of course, should be made in cases of failure to file returns and in cases of false and fraudulent returns.

INSURANCE PAYABLE TO THE UNITED STATES

The burden of taxes on estates for substantial proportions is increased by the necessity of converting the assets of such estates into cash for the purpose of meeting the tax liability. Thus in the very high brackets estates are not only seriously depleted by the tax but may be further depleted by forced liquidation. Assuming that we still adhere to the American tradition of taxation for revenue only and that estate taxes will be substantially reduced as rapidly as the necessities of the Government will permit, our objective should be to alleviate the impact of whatever taxes are imposed.

It has been suggested that these objectives may to a limited extent be reached by permitting taxpayers to acquire policies of insurance payable either to the appropriate Collector of Internal Revenue or to a trustee upon an express trust to pay over the proceeds to such collector, such proceeds to be exempt from estate taxes to the extent of the actual tax liability. The adoption of this proposal will result in facilitating the collection by the Government of the taxes as well as cushioning their impact upon the estate.

It is a common occurrence that substantially all or at least a great proportion of the assets of a decedent's estate are represented by investments in business that are closely held. The effect of the enforcement of the obligation for taxes in accordance with the letter of the law would be devastating. The situation presently must be met by indulgence on the part of the collectors of internal revenue.

The argument might be raised that the proposal makes it possible for a taxpayer to exempt a substantial part of his estate by payment of premiums which might otherwise constitute a part of his estate at death, but there is no assurance that such sums will survive life's vicissitudes any more than there is assurance that ordinary life insurance policies will not be forfeited or encumbered to the full extent of their loan values. The use of premiums for the purchase of insurance which cannot be availed of for any other purpose than the creation of a fund to defray an obligation to the Government insures against their dispersion and creates a value desirable both from the taxpayer's and the Government's point of view. In any event, it seems that the objective is worth whatever incidental sacrifice may be entailed.

STATUTE OF LIMITATIONS

The general limitation prescribed in section 275 of the IRC for the assessment of taxes is 3 years. In case of false or fraudulent returns or failure to file returns, assessment may be made at any time. The time for collection after assessment is 6 years. These provisions are fair to taxpayer and Government.

In the Revenue Act of 1934 several amendments were made. We direct attention to subdivision (c) of section 275, which extends the period for assessment to 5 years in cases where the taxpayer omits from his gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return.

Either the 3-year period of limitation is a proper one or it is not, and the criterion of this is not to be found in the extent of the error which has been made. If returns are examined by the Bureau of Internal Revenue in due course, omissions from a return will be discovered whether they are large or small, except in the case of false or fraudulent returns where no limitation whatever is prescribed. The omission of so substantial a portion of gross income will, except in case of fraud, be the result of a well-grounded and well-justified belief that what has been omitted is not income, or at least not taxable income, and that it is within those categories will be known only after a tribunal of competent jurisdictions has passed upon it.

The section seems to have no other purpose or justification than to give the Commissioner of Internal Revenue an escape from the consequences of his own negligence. The size of the error is hardly a proper criterion by which to measure the propriety of statutes of repose. It would be as logical to suggest a sliding scale of limitation based upon the size of the error. We suggest that subsection (c) be repealed.

The same observations apply to subdivisions (d) and (e), in which the statute of limitations is extended to 7 years in cases involving stockholders' shares in foreign personal holding companies and personal service corporations.

OUR ARCHAIC SYSTEM OF TAX ASSESSMENT AND COLLECTION

The collectors of internal revenue are appointed by the Government. Their status is somewhat anomalous. They appear to be independent entities at one moment and representatives of the Government at another.

Returns are filed with the collectors. The liability of a taxpayer is charged against the collector in whose office the return is filed. He becomes a debtor of the United States. He operates independently and the Treasury Department disclaims any right to interfere with him in the performance of his duty. If he fails to effect collection, he must file an application to the Treasury to abate his liability to the extent of such failure and presumably is expected to furnish adequate reason for his failure to do so in order to obtain relief. He may be sued by a taxpayer for recovery of taxes erroneously collected and in the event of recovery the judgment becomes an obligation of the United States provided the court in which the action is tried issues a certificate of probable cause.

After assessment, further proceedings or negotiations frequently ensue. During their pendency a request of the Commissioner for forbearance meets with the information that that is a matter between the taxpayer and the pursuing collector. The latters feels his responsibility; he will forbear if the Commissioner requests it, which the Commissioner will not do. The taxpayer may after agonizing efforts obtain the indulgence he seeks, but he will have a very unhappy experience of buck passing in the meantime.

This procedure has been in effect without fundamental change for more than 75 years. Suggestions for its simplification seem hardly to be necessary since they ought to be obvious. The conception of a debtor and creditor relationship between the United States and the various collectors of internal revenue and their separate and independent status which obtains only in theory and at convenience savors of childhood fantasy.

The United States is the creditor. The Commissioner of Internal Revenue is chargeable as its agent with the duty of assessing and collecting the tax. The collectors of internal revenue should be his agents for that purpose and all the red tape incident to the present procedure should be eliminated.

We direct attention to the provisions for the recovery of overpayments of taxes. The United States Tax Court has jurisdiction to determine whether an overpayment has been made in a year in which a deficiency is asserted. Though the court is held in very high esteem, its authority in relation to overpayment goes no further.

The Government is very jealous of its sovereign rights. It vests jurisdiction of suits for the recovery of taxes primarily in the Court of Claims but accords the right to a taxpayer to bring suits against the United States for such recoveries in a district court of the United States provided the amount involved does not exceed $10,000 (or the collector to whom the taxes were paid is dead or out of office). Here comes the anomaly. The collector, being theoretically an independent entity being charged with an erroneous and illegal collection, may be sued in the district court for any sum. When judgment is recovered against him the United States assumes the obligation upon a certificate of probable cause.

If the suggestions for simplification of the relations between the United States and the collectors are followed, suits against the collectors would naturally fall. The question would then present itself whether the limitation of suits against the United States in the district courts should be continued or be raised to a very substantial degree. It is desirable of courts to make local courts available to taxpayers but the limitation to $10,000 hardly reflects confidence in our courts which the Government should be the first to profess. A system which limits a suit against the United States to $10,000 in the district court and subjects it to liability for millions in a suit against the collectors, requires correction.

IN CONCLUSION

Viewing the excessive rates of taxation on incomes, gifts, and on the estates of deceased persons, on capital gains, the double taxation of corporate earnings, the effect of provisions such as section 102, we cannot but perceive that any economic progress we may make will have to be accomplished in the face of almost insurmountable obstacles; and, as we have endeavored to demonstrate, the complications and inequities of the taxing statutes are not the least of its infirmities. We must raise the money needed for the support and maintenance of the Government. We do not have to do it oppressively, nor for political purposes, nor in pursuit of idealogies, and we can do it by simple legislation that everyone who runs may read. The last is the consummation devoutly to be wished.

TABLE A

1925	459, 717, 623	1939	262, 029, 599
1926	451, 868, 353	1940	207, 599, 749
1927	581, 702, 342	1941	170, 603, 671
1928	930, 893, 276	1942	125, 685, 298
1929	1, 124, 800, 410	1943	278, 741, 765
1930	810, 632, 546	1944	263, 074, 018
1931	576, 765, 412	1945	377, 565, 575
1932	425, 234, 204	1946	363, 709, 312
1933	654, 816, 452	1947	253, 623, 804
1934	323, 845, 631	1948	302, 218, 965
1935	381, 635, 752	1949	272, 293, 402
1936	496, 046, 869	1950	524, 799, 621
1937	409, 464, 570	1951 (to date June 11, 1951, inclusive)[1]	227, 815, 942
1938	297, 466, 722		

[1] Against 218,819,026 same period of 1950.

TABLE B.—*Taxation of long-term capital gains*

Years	Length of time capital asset had to be held	Percentage of recognized gain which had to be included in income	Tax rate	Maximum effective tax rate on gain
1921 to 1934	More than 2 years	100	12½ percent	No special provision.
1934 to 1938	More than 10 years	30		
	More than 5 years but not more than 10 years.	40	Regular normal and surtax rates.	Do.
	More than 2 years but not more than 5 years.	60		
	More than 1 year but not more than 2 years.	80		
	Not more than 1 year	100		
Jan. 1, 1938 to 1941	More than 18 months and less than 24 months.	66⅔	do	30 percent.
	More than 24 months	50		
1942 to present	More than 6 months	50	do	50 percent of gain included in income.

Senator BYRD. The first witness this morning is Mr. John W. Caffey.

Senator MARTIN. Mr. Chairman, I would like to state that Senator Millikin is not well and cannot be here on this side of the committee.

I will have to leave myself because I must testify before two committees this morning, and I feel this is one of the very important things confronting us, because we will probably get into the question of law enforcement and things like that.

We do not want to get back to the days of the eighteenth amendment, so I think it is very important. I want to say this to you, Mr. Chairman, that it is my intention to very carefully read the testimony, and I know the other members will, and I am sorry that we do not have the representation here this morning.

Senator BYRD. We understand your situation; we are sorry you will not be here. If you can get back, we will be glad to have you here.

Senator MARTIN. I will get back if I possibly can, but I have got to appear before two committees this morning. I think a lot of folks do not realize the conflicts that come along. I asked to testify before a couple of committees this morning, and, of course, I have got to be present, so if you will excuse me I will try to get back, but I am not sure.

Senator BYRD. Mr. Caffey, counsel, Wine Conference of America.

STATEMENT OF JOHN W. CAFFEY, COUNSEL, WINE CONFERENCE OF AMERICA

Mr. CAFFEY. My name is John W. Caffey. I am a lawyer, with offices at 1523 L Street.

Out of deference to the chairman's request, the wine industry is filing their prepared statement.

Senator BYRD. Thank you very much, Mr. Caffey.

Mr. CAFFEY. If there are questions that any of the members wish to ask, I will try to undertake to answer them.

Senator BYRD. Thank you. There are none. You may insert your statement into the record.

(The prepared statement of John W. Caffey referred to follows:)

STATEMENT ON BEHALF OF THE AMERICAN GRAPE AND WINE INDUSTRY

The American wine industry, consisting of 158,000 grape growers in 44 States, and 800 bonded wineries, most of which are family owned and operated, produces a beverage of moderation and temperance for home consumption; and although this basically agricultural industry is still in its infancy in America, it always has evidenced a willingness to contribute, in the form of taxation, its share of the ever-expanding cost of maintaining and defending our form of government.

This attitude was made clear by the grape and wine industry witnesses who appeared before the Committee on Ways and Means, in protest against original Treasury Department proposals that excise taxes on wine be increased up to 233⅓ percent over the present rates.

We attach hereto (exhibit No. 1) the statement of Mr. Harry Baccigaluppi, former president of the wine industries insitute, setting for that committee the economic background of the Nation's grape and wine industry. This statement points out the disastrous effects of the proposed rates upon the grape and wine industry, particularly in view of the Treasury Department's own decision, T. D. 5829, issued February 22, 1951, which officially classified the wine industry as one of the only eight depressed industries (and the only agricultural industry) entitled to special consideration for excess profits tax treatment for the taxable years ending after June 30, 1950. Furthermore, the Treasury experts and technical staff estimated that the recommended increases, if enacted into law, would result in a decrease in wine consumption variously stated from 15 percent to 25 percent.

The immediate impact of the increases originally proposed, upon the grape farmers throughout the Nation, reached such proportions that there were few Members of the Congress who were not literally besieged with protests and appeals for assistance. These farmers and their allied associates in business, who for years had labored in their vineyards with the thought that they were approaching a new day, well knew the catastrophic effect on their hopes and aspirations if the Treasury's recommendations were enacted into law.

So strong and sincere were the protestations, that the California delegation in the House of Representatives, numbering 23, and representing a State which produces about 85 percent of all of the wine in America, and having about one-third of its total acreage in fruits and nuts, filed with the Committee on Ways and Means a resolution unanimously expostulating the Treasury's recommendation and appealing for fair and equitable treatment (exhibit No. 2). Several members of this delegation also appeared in person before the committee in further presenting their views. In addition, two distinguished Congressmen from the State of New York vigorously pleaded for a nondiscriminating tax on wine. The American Farm Bureau Federation, the California Department of Agricultural, and other organizations joined in the demonstrations. The California General Assembly unanimously passed a resolution memorializing the Congress to refuse to enact the proposed discriminatory tax on wine (exhibit No. 3). Many editors, including Collier's magazine (see April 14, 1951, issue, p. 80) (exhibit No. 4) took occasion to severely criticize the Treasury recommendation for wine taxes. A complete list of the grape and wine industry witnesses appearing personally before the Committee on Ways and Means is attached hereto (exhibit No. 5).

The Committee on Ways and Means made a sane approach to this subject matter and undoubtedly made a complete and thorough study of the Treasury's proposals and of the end result upon the wine industry, as is evidenced by the language employed by the committee in its report to the Congress on H. R. 4473 (see Record p. 40), to which your attention is specifically, but respectfully, directed. The committee flatly rejected the Treasury's proposals and adopted for wine an average over-all increase of about 12½ percent. The following is quoted from that committee's report to the Congress.

"Your committee deemed it appropriate to make only a moderate increase in the case of taxes on wines because of the importance of wines to the grape-growing industry. Between one-third and one-half of the total grape crop is customarily absorbed by wine. The demand for wine, therefore, also has an important effect on the prices which can be obtained by producers of raisins and fresh grapes, the two other important uses of grapes. Moreover, in view of the fact that it has been necessary for the Department of Agriculture at times since the end of World War II to support the price of raisins, it would appear inappropriate for your committee to make a substantial increase in the tax on wine which might have the effect of requiring further price supports. In addition, it should be pointed out that wine consumption in the United States relative to consumption of other forms of alcoholic beverages is relatively low when compared to relationships generally established abroad. Moreover, the wine industry is one of the few industries which has been classified under the excess-profits tax as a depressed industry."

In addition, the minority report attached to the committee report, among other things, states, at the bottom of page 150:

"* * * excise taxes on items now taxed have reached their limit."

We feel that the committee originating this bill did not arrive at its conclusions until it had exhausted all sources of available information as to what a fair and just tax on wine ought to be as related to other items on which excise taxes are levied. This conclusion was, of course, based on the information available to it at that time.

Subsequently, however, on July 10, 1951, the Department of Agriculture released its preliminary annual estimate of the grape crop which reflects an estimated yield this year of 3,270,700 tons of grapes—an all-time high (4.8 percent increase over the record year of 1946). This agriculture report forecasts for us a potential surplus of grapes and decline in values and in returns to farmers and wineries similar to that experienced by our industry in 1947-49, following the surpluses created by the 1946 crop. The same situation again confronts us as that which lead the Treasury Department to find us a "depressed industry" in its Treasury Decision No. 5820 referred to in the report of the Committee on Ways and Means.

Furthermore, wine sales so far this year, under existing tax rates, have experienced a sharp decline compared with sales for the same period last year - a drop of 10 percent. This means more carry-over inventory to be added to the forthcoming surplus crop this fall.

Thus we find ourselves in a peculiar position in that, as late as the end of June of this year, the industry felt that it could accept the increased excise taxes provided in H. R. 4473 without greatly disturbing its financial and economic structure; whereas now, only a month later, we are compelled to ask the Senate Finance Committee to delete from the tax revision bill any increase in excise taxes on wine because of the pertinent and appropriate reasons heretofore cited. We are not "blowing hot and cold" and are exceedingly reluctant to ask the Senate for this relief from an adverse condition which was heretofore unpredictable; but this is further proof of the constantly perilous and aleatory position of the wine industry.

It should be borne in mind that grape growing, like the growing of peaches, apples, and other tree fruits, is a strangely unique and hazardous farming venture, because it is not subject to annual crop rotation to offset surpluses and shortages.

It requires 5 or 6 years for vine plantings to come into maturity and productivity and once a vineyard is started, there is no opportunity to supplant it with another crop without suffering the loss of the total original investment. When the cotton, grain, tobacco, potato, or peanut producer experiences a year of bumper or surplus crops, he can readily adjust planting in the light of the carry-over or shortage resulting from the previous crop. Not true with the vineyardist. When he puts his labor and earnings in the ground, he, of necessity, lives with the result for many, many years to come and necessarily has to gamble with climatic conditions and other acts of providence which he is utterly helpless to control. Furthermore, much of the land planted to grapes is not suitable for any other cash crop.

The wine industry, under normal conditions, provides a continuing market outlet for about 50 percent of all the grapes grown in the United States. Indeed, the wineries are really the stabilizer for the nation's 158,000 grape growers, employing some 350,000 people with a total investment of approximately $575,000,000. 95 percent of all bonded wineries have their own vineyards and only a small percentage of the total wine production in this country is controlled by large corporations. Even these depend on widespread purchases from grape growers.

The present tax rate on table and dessert wine represents from $24 to $48 per ton of grapes depending on the tax grade, in direct Federal excise taxes, while the average return to growers from grapes during the last 4 years was only about $38 per ton. Thus we find that, like the tobacco farmer, the grape grower's return is only about the same amount the Federal Government extracts in excise taxes.

Moreover, wine represents only about 5 percent of the consumer dollar spent for alcoholic beverages, and is the least stable and the least profitable alcohol beverage industry. Consumption of wine is less per capita than other alcoholic beverages and, as a comparatively new American industry, it must undergo further reasonable development and expansion if the grape industry is to move its surplus crops and service.

With reference to the tax imposed on champagne and other sparkling wines, which have been unjustly taxed as "the rich man's drink," we respectfully petition the committee to (a) reduce the presently existing champagne rates to a more proportionate figure, and (b) that the champagne tax be levied on a gallonage basis as in the case of other types of wine in lieu of the existing ½-pint unit basis. This latter proposal would cost the Treasury nothing and remove a needless burden imposed on champagne producers. Actually the Treasury is collecting more tax dollars on champagne than the law itself contemplates for the reason that the tax is levied on ½-pint units when champagne is packaged in 1/20th, 1/10th and 1/5th gallon containers. Adjustment of this inequity is long overdue.

Respectfully submitted, this 30th day of July, 1951.

WINE CONFERENCE OF AMERICA[1]
By: GREYTON H. TAYLOR, *Chairman*,
JOHN W. CAFFEY, *Counsel*.

EXHIBIT 1

STATEMENT OF HARRY BACCIGALUPPI BEFORE THE COMMITTEE ON WAYS AND MEANS, MARCH 12, 1951, WITH REGARD TO PROPOSED WINE EXCISE TAXES

My name is Harry Baccigaluppi. I am president of the California Grape Products Co., a medium-sized winery at Delano, Calif. We have grapes of our own, and regularly crush grapes for our neighbors who have vineyards in that area.

I am speaking today not only for myself and our growers, but also for the rest of the winegrowers in California. I happen to have served two terms as president of the Wine Institute, which is the trade association for the California wineries, and our members have asked me to express their views with mine.

In addition, I should like to point out that the Wine Institute is a member of the Wine Conference of America. The conference is a national group composed of 19 wine associations from all of the principal wine-producing and wine-marketing areas in the United States.

I naturally will speak primarily from my own California experience. Mr. Greyton Taylor, the chairman of the Wine Conference, who will address you a little later, is from Hammondsport, N. Y., in the Finger Lakes district. He will address you from the point of view of the wine-growing industry in States other than California.

All of us, from all over the country, are affected quite similarly by the proposed taxes, and the witnesses you will hear today represent the unanimous view of all persons in this country engaged in growing grapes and other fruits for wine, in producing wine, or in bottling wine for market.

II

We all realize that there is a serious need for additional revenue, and I doubt very much whether we should have appeared before you today if the Treasury's proposals for increased wine excises had borne any reasonable relationship to the economics of growing grapes for wine, and preparing the wine for market and selling it. We must necessarily look at our position from a long-range point of view, for we feel that the imposition of these new taxes, on top of the already substantial so-called temporary rates established in 1944, is going to be with us for a long time to come.

The Treasury has proposed to you the following rates:

Table wine: 50 cents per gallon; a 233-percent increase over the present rate of 15 cents per gallon.

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[1] The Wine Conference of America is the official national organization representing the grape growers and the producers and distributors of wine. It comprises the various State and sectional grape and wine industry associations, representing 98 percent of the movement of all wine in the United States, a list of which follows:

American Wine Association, 292 Madison Avenue, New York, N. Y.
Associated Vintners of the Middle West, 33 North LaSalle Street, Chicago 1, Ill.
Bottle Fermented Champagne Producers, Inc., 901 Barr Building, Washington, D. C.
Council Bluffs Grape Growers Association, 900 South Seventh Street, Council Bluffs, Iowa
Finger Lakes Wine Growers Association, Naples, N. Y.
Maryland Institute of Wine & Spirits Distributors, Inc., Suite 600, Hearst Tower Building, Baltimore, Md.
Michigan Wine Institute, 460 South Kalamazoo Street, Paw Paw, Mich.
National Association of Alcoholic Beverage Importers, Inc., room 700, National Press Building, Washington, D. C.
Wine Association of Pennsylvania, Post Office Box 6790, Philadelphia, Pa.
National Wine Association, care of Monarch Wine Co., Brooklyn, N. Y.
Ohio Grape Growers & Vintners, Post Office Box 595, Sandusky, Ohio
Ohio Grape Growers Institute, 31734 Lake Road, Avon Lake, Ohio
Ohio Wine Dealers Association, 53 St. Clair Avenue, Cleveland, Ohio
North Carolina Association of Wine Control, Apartment 4–A, Carolina Hotel, Raleigh, N. C.
Texas Wine Association, Brown Building, Austin, Tex.
Vermouth Institute, 601 West Twenty-sixth Street, New York, N. Y.
Washington Wine Council, 9117 East Marginal Way, Seattle, Wash.
Wine Distributors of Northern California, 814 Montgomery Street, San Francisco 11, Calif.
Wine Institute, 717 Market Street, San Francisco 3, Calif.

Dessert wine: $1.50 per gallon; a 150-percent increase over the present rate of 60 cents per gallon.

Sparkling wine: $4.40 per gallon; a 47-percent increase over the present rate of $3 per gallon.

Carbonated wine: $3 per gallon; a 50-percent increase over the present rate of $2 per gallon.

I think this Treasury proposal can be illustrated another way. During this last calendar year excise taxes yielded $72 million from the 140 million gallons of American and foreign wines consumed in the United States. The Treasury has stated to you that, under its proposed rates, it will collect $170 million in wine excises, which is an over-all increase of 135 percent in the tax bill for wine. This means a weighted average of about $1.20-per-gallon tax on all the various kinds of wine now moving to market as compared to the present over-all weighted average of 51-cents-per-gallon tax.

The Treasury's proposals have greatly alarmed growers and vintners all over the country. To explain why we are so alarmed may take explanation of a kind that does not often arise before the Committee on Ways and Means.

I believe I am correct in stating that wine and tobacco are the only agricultural industries subject to an excise tax for revenue purposes. Substantial excise taxes raise special problems with respect to any industry of an agricultural nature. The Treasury's proposals will require going into our agricultural economy in some detail, but we shall try to be as brief as possible in getting the principal facts before you.

III

To give a proper perspective to our problem, I think I ought to point out, first, that winegrowing is definitely not big business in this country. It is primarily small business, not only as an industry, but also with respect to the individual persons or firms engaged in it.

The Department of Commerce has published estimates of the number of dollars the consumer pays for alcoholic beverages, and their figures show that, in the last few years, consumers have been willing to pay only about $500 million annually for all wines (California, eastern, and imported). This was during a period when consumers bought a maximum quantity of wine, culminating in the 1950 consumption figure of 140 million gallons.

Nevertheless, this expenditure was only about 5 percent of the total amount spent for all alcoholic beverages. The consumption of wine is only slightly over nine-tenths of a gallon per capita which is also less than that for any other beverage. From these figures it is quite obvious that winegrowing is not a big industry.

Next, within the industry itself there is a tremendous number of sharply competing units. There are over 800 bonded wineries spread through 20 States, on top of which there are approximately 500 wholesalers, who bottle wine brought in bulk from grape-growing areas to areas of local distribution. These 1,300 units take practically every form of known business organization—individuals, partnerships, and farm cooperatives, as well as stock corporations that are usually family-owned. Some produce wine from their own grapes, others buy grapes to add to the supply from their own vineyards, others produce wine on contract either with local growers or with purchasers of wine from other areas. On the average, however, about 50 percent of the grapes crushed for wine are crushed by the owners of the vineyards where they are grown.

According to the 1947 census of manufactures, the average employment in the 418 winery firms analyzed was only 20 employees per firm.

The United States wine industry, with only 5 percent of the alcoholic-beverage business, is not only a relatively small business in itself, but the entire business that we now have must be divided many ways among a tremendous number of competing units.

IV

I have said that about 50 percent of the grapes crushed for wine are crushed by the owners of the vineyards where the grapes are grown.

It is also a fact that about 50 percent of all grapes grown and moved to market are moved to market in the form of wine.

The total customary outlets for grapes are either fresh shipment (in which form the crop is perishable), or in some nonperishable or semiperishable state such as dried fruit, or wine, or grape juice, or jams, jellies, and preserves.

These different outlets for grapes are utilized by the farmer as supply and demand may dictate. In many cases it is possible for the farmer to select all or several of these outlets for his crop as he may think most advisable. In other cases, individual farmers might be confined to a single one of these market outlets because of the particular varieties of grapes they grow or the locality in which they are grown. But the net effect on the industry as a whole has been that any impediment to the movement of grapes, into any single outlet, will cause an oversupply of grapes in the other possible outlets, with parallel reductions in returns to growers from all outlets.

For example, in our State of California, next to grapes for crushing into wine the drying of grapes into raisins is a principal outlet for the farmer's grapes. If an impediment is placed on the movement of grapes into wine, then an excess of grapes will be moved for drying into raisins, with resulting lowered returns to farmers for their crop, and the lowered returns in the wine field will be reflected in comparably lower returns in the raisin outlet. In the Eastern States, where the climate is not suitable for drying, a comparable outlet is found in processing grapes into grape juice or into jams, jellies, and preserves. Here, too, any impediment to the wine outlet for grapes is bound to have an adverse effect on farmers attempting to supply the other processing outlets mentioned.

The assistant Director of the California State Department of Agriculture, Mr. W. C. Jacobson, will follow me and explain to you this relationship between the various outlets for grapes in more detail, but I should like at this point to emphasize that a tax on any single outlet for grapes that becomes an impediment to the movement of grapes into that outlet, becomes in fact a tax on every other outlet for grapes even though these other outlets are not mentioned in the tax bill. Thus, a tax on wine is also a tax on raisins and on grape juice, unless it is set at a level which can be fully absorbed by wine purchasers.

V

The next thing I should like to point out is the very wide fluctuations from year to year between supply and demand, because, like other farm crops, we cannot control growing conditions and thus cannot control supply from year to year.

At the vineyard level you find variations due to weather and to other factors that cause substantial variations in the tonnage of grapes. In recent years the yield of grapes in California has ranged from about 2,300,000 tons to 2,800,000 tons, which is a variation of approximately 10 percent up or down from the average. This is a fluctuation which, I believe, would be considered normal over a long-term period. This 10-percent fluctuation represents 500,000 tons of grapes which, when translated into wine, means a possible variation of 50 million gallons, or more than one-third of the present demand for wine in this country.

In the wine outlet, a normal variation under current conditions would be about 300,000 tons, equal to about 30 million gallons of wine or about 20 percent of the current demand for wine. Under abnormal conditions this variation has reached as high as 500,000 tons of grapes. These fluctuations in the available supply of grapes for wine cause sharp annual variations in returns to growers from the wine outlet. Since 1934, wine has returned to California grape growers an average of 70 percent of parity. In giving you this figure of 70 percent, I am leaving out the abnormal years of 1942 through 1946 when the Government went into the market for abnormally large quantities of dried fruit for lend-lease and the Marshall plan, with the result that there were nowhere near enough grapes to satisfy the normal demand for wine.

This 70-percent figure is not an official published figure for grapes crushed for wine but has been calculated from the data available for parity values for grapes for all purposes.

The exact figure itself is not important, whether it be somewhat higher or somewhat lower than 70 percent. The important fact is that in arriving at this 70-percent average, since 1934, there were sharp variations from year to year ranging as low as 50 percent of parity and as high as 98 percent of parity. This is roughly a variation in returns from plus 33⅓ percent to minus 33⅓ percent from the average.

The point I wish to stress particularly to the committee is that over a long-term period the business of growing grapes for wine, and producing wine, is one in which we must expect very substantial variations in returns in order to arrive at the average level of return which our particular business involves. Incidentally, I believe that you will find that an average long-term return of 70-percent parity is not a particularly high level of return for an agricultural industry.

A very striking illustration of the low end of these fluctuations occurred just recently. On February 2 of this year, the Treasury Department issued Treasury Decision 5820 announcing that eight industry groups had been determined to be "depressed industry" groups for excess-profits-tax purposes. Wine making was the only food or food-products industry group contained in the list. This determination was made for the years 1946 through 1949.

What had happened was that an oversupply of grapes had been made into wine from the 1946 crop, and this had depressed the wine market very sharply in the spring of 1947. This depressed condition continued until last spring, when supply finally began to adjust itself to demand. This last fall, growers received $61.15 for their grapes, but in the crop years 1947, 1948, and 1949, they received only $29.80, $30.30, and $26.80, respectively, which was barely above estimated cost of production.

The points I want to make to the committee are—

(a) That, in our industry, there is no control over supply in relation to demand.

(b) That we go through periods of substantial depression, and

(c) That these depressed conditions exist alike for both the growers and the vintners.

Incidentally, I am somewhat puzzled as to how the Treasury Department managed to draw the conclusion that an industry, which had been so thoroughly depressed for several years running, could suddenly become the source of 135 percent more excise revenue than it is now providing.

VI

I have tried to give the committee a picture of how the wine industry normally operates and of its extremely close connection with grape growing.

I should like now to revert to the Treasury's tax proposals.

The first noticeable thing is that their estimate of increased yield of revenue from the new rates is substantially lower, percentagewise, than the percentage increase in the rates themselves. They estimate that the present rates, if continued, would bring in $80 million a year (although they have actually only collected $72 million this last year) and then they estimate that the new rates would bring in an additional $90 million. This is an estimated revenue increase of 112 percent, but the percentage increase of the new rates, on a weighted average basis for the various kinds of wine, is about 170 percent. In other words, a rate increase of 170 percent is expected to increase revenues by only 112 percent.

Obviously, the Treasury anticipates that its proposed rates will cause a definite reduction in volume of wines to be sold in the future. They have not given a specific estimate of what this reduction would be, but, using different methods of calculating, they apparently anticipate a decline in volume of about 15 to 20 percent.

Using the more conservative figure, a decline of 15 percent in consumption would mean a reduction of over 20 million gallons from present sales. This is the equivalent of loss in market outlet for 200,000 tons of grapes and a loss of grower income of about $12 million a year at present grape prices, or 15 percent less grower income from wine. In addition, this extra tonnage of grapes would become surplus, depressing the values of all grapes and further lowering grower income.

VII

The thought I should like too leave with the Coommittee is that its past tax policy with respect to wine has been fair and equitable. At the time of repeal of prohibition there was practically no wine industry. The old wine industry had almost been destroyed and had to be rebuilt from the bottom. Per capita consumption of wine in the middle thirties was almost neglible. Through our own efforts in improving wine standards and technical methods of production, in encouraging improved grape plantings, and in educating the public to know what the varius kinds of wine are and how they are properly used, we have managed to more than double the consumption of wine and push the per capita consumption to almost 1 gallon. By the standards of other wine-producing countries, where per capita consumption may range anywhere from 10 to 80 gallons, this is a ridiculously low figure. Nevertheless, it represents slow progress in building an industry where there was no industry before, and which most people doubted could ever be reestablished. It has opened up to cultivation farm lands that in many cases were not suitable for other crops. It has directly or indirectly, in its own small way, helped to improve the general economy of the country by directly or indirectly providing a living for thousands upon thousands of people.

In the past, we have gone through stages of depression which have sometimes been quite serious and the one which started in the spring of 1947, which I referred to a moment ago, was a pretty bad one.

We feel that your past excise-tax policies have recognized the nature of our industry and have made allowance for its economic problems. During the depression of the last 4 years, the present excise rates were a little tough to handle at times. I cannot prove this statistically, but I know from my own experience that the market for a good percentage of the wine we moved during that period was such that at least some portion of those excise taxes were paid out of the pockets of the growers and the vintners.

I know also that many of the smaller-business units, in both the producing and bottling end of the business, are finding some difficulty under the present tax structure; the proposed increases would result, in my opinion, in the eventual elimination of the major portion of the smaller units, most of which are family businesses, because they could not meet the additional financial burdens which the proposed tax increases would place on them.

I believe you can understand why the Treasury's tax proposals have alarmed us so.

I feel sure that we can count on continuing to receive fair and equitable consideration from this committee.

Thank you very much.

EXHIBIT 2

RESOLUTION

To the Honorable Robert L. Doughton, Chairman, and Members of the House Committee on Ways and Means:

Whereas the growing of grapes, berries, and fruits for wine production is an important part of California's agricultural economy, the State having 500,000 acres of bearing grapes, 383 bonded wineries, and an average annual grape crop of 2,703,000 tons, returning to farmers an annual average of $137,927,000; and

Whereas the Treasury Department's recommendation for increased excise taxes on wine amount to an increase over and above the present taxation of 150 percent to 233⅓ percent, far in excess of the recommended increase on any other item included in the list and which increase amounts to $50 a ton on grapes for table wines and $72 a ton on grapes for dessert wine; and

Whereas the proposed increase of wine taxes would result in (1) reducing consumption of wines; (2) reducing the income of grape growers; (3) depleting instead of increasing revenue to the Federal Government; (4) dislocating the economic and market balance of the grape industry; (5) demoralizing market outlets for table and raisin grapes; and (6) piling up unsalable surpluses of all types of grapes; and

Whereas these tax increases, if enacted, would place wine in a luxury category and out of the reach of middle- and low-income groups now constituting 80 percent of the wine market; and

Whereas the heretofore well-established and recognized basis for taxing wine as a strictly agricultural product has been deemed to be fair and just and no plausible reason appears for changing this historic concept; and

Whereas the California wine industry is willing to carry its share of the tax burden but can find no justifiable reason for the disproportionate and inequitable proposal advanced by the Treasury Department: Now, therefore, be it

Resolved, That the Agricultural Subcommittee of the California congressional delegation goes on record as opposing the unfair, discriminatory, confiscatory, and excessive increase in Federal excise taxes on wines proposed by the Treasury Department; and be it further

Resolved, That copies of this resolution be transmitted to the House of Representatives Committee on Ways and Means.

Approved.

Agricultural Subcommittee of the California delegation: Jack Z. Anderson, Ernest K. Bramblett, Hubert B. Scudder, Leroy Johnson, Thomas H. Werdel, Allan Oakley Hunter, Clair Engle, John Phillips, John J. Allen, Jr., George P. Miller.

The foregoing resolution has been adopted by the Agriculture Committee of the California delegation in Congress, and was submitted to the full California delegation in Congress and formally approved at a meeting of said delegation held on Thursday, March 8, 1951.

Harry R. Sheppard, Clinton D. McKinnon, Carl Hinshaw, Chet Holifield, Franck R. Havenner, John F. Shelley, Norris Poulson, Patrick J. Hillings, Gordon L. McDonough.

EXHIBIT 3

[S. J. Res. No. 14, introduced by Senators Dorsey, Burns, Roy Cunningham, Abshire, Hoffman, Hatfield, and Donnelly, March 12, 1951]

SENATE JOINT RESOLUTION NO. 14, RELATIVE TO MEMORIALIZING CONGRESS, PROTESTING THE PROPOSED INCREASED TAX ON WINE

Whereas it has been proposed that the Congress of the United States increase the Federal tax on table wines from 15 cents to 50 cents a gallon and on dessert wines from 60 cents to $1.50 a gallon; and

Whereas the growing of grapes, raisins, and wines is a key part of this State's economy and the most important division of the great California fruit-growing industry, alone providing employment for 111,000 workers and returning over $150,000,000 to growers in 1950; and

Whereas the grape and wine industry has been placed in danger of economic ruin by these recommendations to Congress that the excise tax on table and dessert wines be so increased by 150 to 233 percent, increases far exceeding those proposed for other beverages; and

Whereas this would mean an increase in the Federal tax burden on grapes from the present $24 to $48 per ton to the prohibitive figures of $80 to $120 a ton; and

Whereas this would be far out of proportion to the taxes borne by other farm commodities and much the heaviest tax burden ever placed on any American farm product; and

Whereas these tax increases, if enacted, would place wine in a luxury category and out of the reach of middle- and low-income groups now constituting 80 percent of the wine market and would completely disrupt orderly marketing of wine and destroy the largest single commercial outlet for grapes; and

Whereas such increases by destroying the grape and wine industry's ability to survive economically would lead to diminishing returns and not contribute to the national welfare but rather eliminate an important present source of Federal tax revenues: Now, therefore, be it

Resolved by the Senate and Assembly of the State of California (jointly), That the Congress of the United States is hereby respectfully memorialized to refuse enactment of the proposed discriminatory and excessive increase in Federal taxes on wines that would be so disastrous to agriculture in this State, and that would fail to accomplish the intended purpose of increasing the national revenue; and be it further

Resolved, That the secretary of the senate is hereby directed to transmit copies of this resolution to the President and Vice President of the United States, to the Speaker of the House of Representatives, and to each Senator and Representative from California in the Congress of the United States.

Exhibit 4

[Editorial appearing in Collier's magazine, April 14, 1951, issue, p. 80]

* * * And Speaking of Taxes

Another of Mr. Snyder's suggestions for raising revenue is a "whopping" increase in the tax on wine—233 percent on table wine and 150 percent on the dessert variety. This also strikes us as being short-sighted.

The big market for domestic wine is in the middle- and low-income groups. This proposed tax might remove store-bought wine from these families' budgets. But it is a safe, and we hope not too cynical, assumption that it wouldn't remove wine from all their tables. It seems likely that there would be a big increase in home production, not only on the farm but in city kitchens and cellars. Thus a revival of this prohibition-era custom might result in less revenue from wine taxes than the Government is getting now. And that's hardly the way to finance a pay-as-you-go defense program.

Exhibit 5

List of witnesses who appeared before the House Committee on Ways and Means on March 12, 1951, on behalf of the American Grape and Wine Industry:

	House Hearings Record, Page No.
(1) Mr. Harry Baccigaluppi, president, California Grape Products Co., Delano, Calif.; former president of Wine Institute (trade association for the California wineries); speaking on behalf of the wine growers of California	2042
(2) Mr. Matt Triggs, assistant director, Washington office, American Farm Bureau Federation, speaking on behalf of the American Farm Bureau Federation	2128
(3) Mr. W. C. Jacobsen, representing the California director of agriculture and the California State Board of Agriculture, in the first appearances of these agencies before the Committee on Ways and Means	2130
(4) Mr. Greyton H. Taylor, managing partner, Taylor Wine Co., Hammondsport, N. Y., chairman of Wine Conference of America, a national group composed of 10 wine associations from all of the principal producing and wine-marketing areas in the United States. Speaking on behalf of the Wine Conference of America and the Bottle Fermented Champagne Producers, Inc	2145
(5) Mr. William J. Wagoner, grower of wine grapes in the Livermore Valley of Alameda County, Calif.; speaking for thousands of other growers of wine-variety grapes	2177
(6) Mr. Freeman Mills, grape grower from Lodi in the San Joaquin Valley of California; speaking on behalf of thousands of other growers of table-variety grapes	2182
(7) Mr. A. Setrakian, president of California Grape Growers Council; speaking on behalf of growers of raisin-variety grapes	2190
(8) Mr. Walter K. Hines, vice president of California Grape Growers Council and general manager of Sun-Maid Raisin Growers of California, Fresno, Calif.; speaking on behalf of raisin-grape growers and raisin producers	2198
(9) Hon. Leroy Johnson, Representative, Congress, State of California	2577
(10) Hon. Hubert B. Scudder, Representative, Congress, State of California	2016
(11) Hon. Thomas H. Werdel, Representative, Congress, State of California	2039

Senator Byrd. Mr. Clinton M. Hester.

Mr. Hester, you have 10 minutes.

STATEMENT OF CLINTON M. HESTER, WASHINGTON COUNSEL, UNITED STATES BREWERS FOUNDATION

Mr. HESTER. Mr. Chairman and members of the Senate Finance Committee, my name is Clinton M. Hester. I am an attorney located in the Shoreham Building, this city. We appear here today as Washington attorney for the United States Brewers Foundation, 21 East Fortieth Street, New York City.

Our client, the United States Brewers Foundation, is a trade association representing the interests of the brewing industry of this country. It is the second oldest trade association in the United States and has been in continuous operation since 1862.

Of the approximately 400 breweries in the United States its membership includes about 200 brewers who sell approximately 85 percent of the beer produced in the United States.

We presented at length before the House Ways and Means Committee on March 12 our views on the recommendation of the Secretary of the Treasury that the tax on beer be increased from $8 to $12 per barrel. On March 21 we testified concerning loss of excise-tax revenue to the Government which would result from the order issued by the National Production Authority on January 26, 1951, restricting the use of tin cans for packaging beer.

Beer produces annually nearly $700 million in Federal excise taxes or enough revenue in 1 year to pay the entire expenses of the Congress of the United States for 10 years. Beer also produces nearly $200 million each year in State excise taxes, which revenue is used in many States to pay old-age pensions and teachers' salaries.

The proposal of the Secretary of the Treasury would require beer to produce annually in excise taxes in excess of $1 billion or to pay to the Federal Government in excise taxes approximately one-seventieth of the Federal budget of more than $71 billion recommended by the President for the fiscal year commencing July 1, 1951.

The Secretary opposes both a Federal sales tax because it would have to be paid by those least able to pay such a tax; and an excise tax on food, rent, and clothing because they are necessities of life.

In all deference to the Secretary of the Treasury, beer falls within the group of commodities upon which he considers excise taxes should not be imposed. The beer excise tax is an indirect Federal sales tax on a commodity which is one of the necessities of life.

Beer is a food beverage which plays a vital part in American life. Beer is consumed in the homes of two-thirds of the families in the United States. It is an essential food item in the daily diet of the workingman in the heavy industries such as the steel industry.

In World War II the War Labor Board ruled that beer is essential to public morale in times of great national stress.

Beer also aids military morale. Because of this fact, Secretary of War Stimson and Secretary of the Navy Knox during World War II successfully opposed the enactment of legislation which would have prohibited the sale of beer on military reservations.

The brewing industry is an industry essential to our national defense.

Continued tax increases are fast making beer a luxury item and placing it beyond the reach of the workingman, to whom it is an essential food beverage. This is well demonstrated by the fact that within eight blocks of this committee room the average bottle of beer, which only a few years ago sold for from 10 to 15 cents a bottle, now retails from 25 to 40 cents.

Until 1940 beer sales kept pace with consumer disposable income. In 1940, however, Congress increased the excise tax on beer $1, then added a temporary wartime increase of $1 in 1942, and another temporary wartime increase of $1 in 1944. Although consumer disposable income has risen nearly 50 percent since 1944, beer sales have increased only about 5 percent. In fact, beer sales are lower now than they were in 1947, 1948, 1949, and 1950.

When Congress increased the beer excise tax in 1940, there were 684 breweries operating in the United States. Since then more than a third of those breweries have been compelled to go out of business. Many of them were small breweries. Their failure was due in no small measure to high Federal and State excise taxes.

We respectfully submit that the point of diminishing returns in the taxation of beer was reached long ago.

Beer is the only user of tin cans which produces any substantial amount of excise-tax revenue. We estimate that aready the National Production Authority can-curtailment order M-25, issued on January 26, 1951, has cost the Federal Government millions of dollars in beer excise taxes. If the present restrictions on the use of tin cans for beer are continued, the Federal Government will lose millions more in beer excise taxes.

Senator KERR. Let me ask you a question there. Is it your judgment that the restrictions on the use of tin cans has been more detrimental to your business than the excessive taxes of which you talk?

Mr. HESTER. Excessive taxes? I am talking about the excise tax.

Senator KERR. Well, you are taking a position that it is high enough; are you not?

Mr. HESTER. Yes; that is right. That is right.

Senator KERR. When it gets higher than it should be, that is excessive.

Mr. HESTER. That is right.

Senator KERR. I asked you if you thought the restriction on the availability of tin was hurting you as much or more than the taxes that you say are too high.

Mr. HESTER. Well, they are both hurting, but the reason I am bringing this tin-can situation up—I tell that in the next paragraph here—is so that the members of this committee will be acquainted with the situation and you will see what the House Ways and Means Committee did.

Senator KERR. Did you understand my question?

Mr. HESTER. Sir?

Senator KERR. Did you understand my question?

Mr. HESTER. I thought I did.

Senator KERR. I asked you which one you thought was hurting the most. If you do not want to answer, it is all right.

Mr. HESTER. I have not given that any consideration, Senator. I would have to think about that, sir.

Senator KERR. You would not have an opinion offhand?

Mr. HESTER. No; I would not.

Senator KERR. All right.

Mr. HESTER. No; I would not.

Senator KERR. You just are complaining about both of them?

Mr. HESTER. No; we are not complaining about the tin-can situation.

Senator KERR. Then you are talking about both of them?

Mr. HESTER. We are bringing it to your attention.

Senator KERR. All right. You are against both of them?

Mr. HESTER. No; we are not against the tin-can restrictions at all; no. If you will let me finish this, I think you will see——

Senator KERR. I am going to let you finish it. It is entirely up to you whether you want to answer the question. I am trying to get informtaion. That is what you are here for.

Mr. HESTER. Wait, just a minute. Let us not have a misunderstanding about this. I have been appearing before this committee for years, and this is the first time I have had the pleasure of appearing before you.

Do not misunderstand me. I am not refusing to answer your question. You have asked me a difficult question. If you pin me down to it, give me time to consider it. The reason we brought the tin-can situation up was that we are in favor of Government restrictions, but you will see later on in our testimony what we are pointing out is this: That the Government defense agencies are paying no attention to the excise-tax problem in determining how many tin cans shall go to each industry. There are 293 products that are restricted in the use of tin cans, and there are only about 5 of them that bear any excise taxes at all, and beer is the real substantial producer, and yet it has the lowest classification.

Senator KERR. Well, that is fine. You go right ahead with your statement. I was just trying to get information. There may be witnesses after a while who will help me.

Senator BYRD. It will reduce the tax return?

Mr. HESTER. It has already done so. We are just calling it to your attention. We are in favor of Government restrictions.

Senator BYRD. Go ahead with your testimony.

Mr. HESTER. The House Ways and Means Committee was concerned lest defense agencies ignore the revenue angle in issuing curtailment orders. Accordingly, on April 3, 1951, the committee adopted a resolution expressing it to be the sense of the committee that in order to protect the revenue the National Production Authority should not issue any order curtailing the production or distribution of products upon which Federal excise taxes are imposed without consultation with the Treasury Department.

We believe that the facts indicate that the Government agencies concerned have given the revenue angle little, if any, consideration.

In 1950 approximately 20 percent of all beer sales were in cans. For the third quarter of 1951 NPA has allowed brewers a quota of 70 percent of the number of cans that they were using in the third quarter of 1950.

However, brewers are not receiving this quota from the can companies. In fact, the latter are only able to supply brewers approximately 45 percent of the number of cans they received in the third quarter of 1950. In other words, brewers this summer are receiving less than half the cans they received last summer.

In view of the importance to you, the Congress, and the American taxpayers in obtaining the additional revenues necessary to finance our expanded national defense, may we express the hope that the Senate Finance Committee will adopt a resolution similar to that adopted by the House Ways and Means Committee. We believe that the adoption of such a resolution would cause Government agencies to become more tax-conscious in the issuance of orders which affect Government revenues.

If the committee should have any hesitancy in adopting such a resolution, perhaps the committee might be willing to consider the advisability of requesting Mr. Carroll E. Mealey, Deputy Commissioner in charge of the Alcohol Tax Unit of the Bureau of Internal Revenue, to obtain first-hand information as to the effect of the can-curtailment order upon beer excise-tax revenue.

Mr. Mealey could report the results of his investigation to the committee when it is considering the tax bill in executive session.

In 1941 you agreed with our position before this committee that the point of diminishing returns in beer excise taxation had been reached.

You therefore declined to accept the Treasury's recommendation for an increase in the beer excise tax at that time. In the interest of our national defense during World War II we accepted a temporary increase of $1 in 1942 and another temporary increase of $1 in 1944. The 1942 temporary wartime increase has since been made permanent and the 1944 temporary wartime increase is also still in effect.

On the question of diminishing returns—and at this point we would like to incorporate by reference our testimony before the House Ways and Means Committee and the Senate Finance Committee on the revenue revision of 1941. That is only by reference, Mr. Chairman. This testimony will indicate that the brewing industry accepted the $1 increase in the excise tax in 1940 to help meet the cost of national defense.

Then it was discovered that the $1 increase brought the law of diminishing returns into operation. This $1 increased tax was imposed on July 1, 1940. In the first 6 months of 1940 beer sales increased 1 percent, but in the last 6 months of 1940, after the imposition of the $1 increase, beer sales decreased 4.2 percent as compared with the corresponding period of 1939. This, despite the fact that for the year 1940 consumer disposable income was $74,300,000,000, which was an 8-percent increase over the year 1939. This was also a 15-percent increase over the previous 5-year average of $64,600,000,000 in consumer disposal income.

Since 1940 consumer disposal income has increased about 300 percent, while beer sales have increased only about 33⅓ percent, or slightly more than 10 percent of the increase in consumer disposable income. Since experience has always indicated that the sales of mass-consumed commodities follow consumer disposable income, it seems to follow clearly that this committee reached the correct conclusion in finding in 1941 that the law of diminishing returns had become applicable in the matter of beer excise taxation, and accordingly had declined to approve a Treasury recommendation for an increase in the beer excise tax in that year. In view of the tremendous lag in beer sales since 1940, it is quite evident that the law of diminishing returns is even more applicable today than it was at that time.

We know that you have a difficult task ahead of you to raise the tremendous amount of revenue needed for national defense. The brewing industry now, as in the past, is willing to bear its fair share of any necessary increase in taxes. However, we submit that it is not reasonable to unduly burden beer—a basic item in the workingman's daily diet. The brewing industry, represented here at the moment by the United States Brewers Foundation, suggests that corporate and even individual income taxes should be further increased rather than to compel the workingman to pay more in taxes for his beer and thus carry a disproportionate share of the tax burden—a burden which should be borne equally by all taxpayers.

Thank you.

Senator BYRD. Thank you very much, Mr. Hester.

Mr. HESTER. Thank you, sir.

(A prepared statement, subsequently submitted by Mr. Hester, reads as follows:)

STATEMENT OF CLINTON M. HESTER, WASHINGTON COUNSEL, UNITED STATES BREWERS FOUNDATION

Mr. Chairman and members of the Senate Finance Committee, my name is Clinton M. Hester. I am an attorney located in the Shoreham Building, this city. We appear here to day as Washington attorney for the United States Brewers Foundation, 21 East Fortieth Street, New York City. It has been our pleasure and honor to have appeared occasionally before this distinguished committee for almost 20 years, first as a representative of the Federal Government and then for many years as an attorney in private practice.

Our client the United States Brewers Foundation, is a trade association representing the interests of the brewing industry of this country. It is the second oldest trade association in the United States and has been in continuous operation since 1862.

Of the approximately 400 breweries in the United States, its membership includes about 200 brewers who sell approximately 85 percent of the beer produced in the United States.

We presented at length before the House Ways and Means Committee on March 12 our views on the recommendation of the Secretary of the Treasury that the tax on beer be increased from $8 to $12 per barrel. On March 21 we testified concerning the loss of excise-tax revenue to the Government which would result from the order issued by the National Production Authority on January 26, 1951, restricting the use of tin cans for packaging beer.

We wish to thank you for permitting us to present our views to you personally, especially when you have had requests from such a large number of persons who desire to appear in person before your committee. In deference to the wishes of the committee, we shall summarize our oral testimony and incorporate by reference our prior testimony before the House Ways and Means Committee.

We shall necessarily be compelled because of the time limit to state mainly conclusions; but we should like to emphasize that these conclusions are supported in detail in our testimony before the House Ways and Means Committee.

Beer produces annually nearly $700 million in Federal excise taxes, or enough revenue in 1 year to pay the entire expenses of the Congress of the United States for 10 years. Beer also produces nearly $200 million each year in State excise taxes, which revenue is used in many States to pay old-age pensions and teachers' salaries.

The proposal of the Secretary of the Treasury would require beer to produce annually in excise taxes in excess of $1,000,000,000, or to pay to the Federal Government in excise taxes approximately one-seventieth of the Federal budget of more than $71,000,000,000 recommended by the President for the fiscal year commencing July 1, 1951.

The Secretary opposes both a Federal sales tax because it would have to be paid by those least able to pay such a tax; and an excise tax on food, rent, and clothing because they are necessities of life.

In all deference to the Secretary of the Treasury, beer falls within the group of commodities upon which he considers excise taxes should not be imposed. The beer excise tax is an indirect Federal sales tax on a commodity which is one of the necessities of life.

Beer is a food beverage which plays a vital part in American life. Beer is consumed in the homes of two-thirds of the families in the United States. It is an essential food item in the daily diet of the workingman in the heavy industries such as the steel industry.

The founding fathers, and many of our Presidents, Washington, Jefferson, and Madison, to name just a few, encouraged the production of beer in the United States in the interest of public morale. For the same reason, President Franklin D. Roosevelt in March 1933, recommended to the Congress, even before the repeal of the eighteenth amendment, that it enact legislation to permit the sale and manufacture of 3.2-percent beer.

In World War II the War Labor Board ruled that beer is essential to public morale in times of great national stress.

Beer also aids military morale. Because of this fact, Secretary of War Stimson and Secretary of the Navy Knox during World War II, sucessfully opposed the enactment of legislation which would have prohibited the sale of beer on military reservations.

The brewing industry is an industry essential to our national defense.

Continued tax increases are fast making beer a luxury item and placing it beyond the reach of the workingman to whom it is an essential food beverage. This is well demonstrated by the fact that within eight blocks of this committee room the average bottle of beer, which only a few years ago sold for from 10 to 15 cents a bottle, now retails for from 25 to 40 cents.

Until 1940 beer sales kept pace with consumer disposable income. In 1940, however, Congress increased the excise tax on beer $1, then added a temporary wartime increase of $1 in 1942, and another temporary wartime increase of $1 in 1944. Although consumer disposable income has risen nearly 50 percent since 1944, beer sales have increased only about 5 percent. In fact, beer sales are lower now than they were in 1947, 1948, 1949, and 1950.

When Congress increased the beer excise tax in 1940 there were 684 breweries operating in the United States. Since then more than a third of those breweries have been compelled to go out of business. Many of them were small breweries. Their failure was due in no small measure to high Federal and State excise taxes.

We respectfully submit that the point of diminishing returns in the taxation of beer was reached long ago.

Georgia and South Carolina are examples of the operation of the law of diminishing returns in the excise taxation of beer. The per capita consumption of beer in those States is less than 5 gallons compared to a national average of about 17 gallons per capita and an average of 25 to 27 gallons in low-tax States like Wisconsin and Michigan. Due to declining beer sales Georgia recently reduced its tax of $9 per barrel to $4.50 per barrel of beer. South Carolina only a year ago increased its beer tax from $9 per barrel to $13.95 per barrel. Because of the rapid decline in the past year in beer sales due to the higher tax South Carolina recently reduced and restored the beer tax to the previous rate of $9 per barrel.

Beer is the only user of tin cans which produces any substantial amount of excise tax revenue. We estimate that already the National Production Authority can curtailment order M-25 issued on January 26, 1951, has cost the Federal Government millions of dollars in beer excise taxes. If the present restrictions on the use of tin cans for beer are continued the Federal Government will lose millions more in beer excise taxes.

The House Ways and Means Committee was concerned lest defense agencies ignore the revenue angle in issuing curtailment orders. Accordingly, on April 3, 1951, the committee adopted a resolution expressing it to be the sense of the committee that in order to protect the revenue the National Production Authority should not issue any order curtailing the production or distribution of products upon which Federal excise taxes are imposed without consultation with the Treasury Department.

We believe that the facts indicate that the Government agencies concerned have given the revenue angle little, if any, consideration. Of the approximately 293 products packaged in tin cans and restricted in the use of tin cans by NPA order M-25, only a few of these products produce any excise tax revenue and none comparable to the revenue produced by beer. Of the entire 203 products, beer is among the 37 products which are given the very lowest classification. So we cannot escape from the conclusion that the revenue aspect has not received adequate attention.

In 1950 approximately 20 percent of all beer sales were in cans. For the third quarter of 1951 NPA has allowed brewers a quota of 70 percent of the number of cans that they were using in the third quarter of 1950. However, brewers are not receiving this quota from the can companies. In fact, the latter are only able to supply brewers approximately 45 percent of the number of cans they received in the third quarter of 1950. In other words brewers this summer are receiving less than half the cans they received last summer.

There is further evidence that the can-curtailment order has seriously affected excise taxes. In January of this year beer sales were increasing due to the tremendous increase of consumer disposable income. Beer excise-tax revenue to the Federal Government in January of this year was approximately $2,400,000 more than it was in January 1950. But since the issuance of the can-curtailment order on January 26 beer sales, instead of increasing above those of 1950, have decreased. In fact, in June of this year beer sales decreased approximately 6 percent below the sales in June of 1950—a loss in revenue of $4 million. If this percentage decrease continues through the third quarter, the Government will lose an additional $16 million.

Now that we are in the peak of the beer season we expect a much greater decrease in beer sales. This decline is expected notwithstanding the fact that bottle manufacturers are now able to supply some bottles, over and above the number used by the industry in the third quarter of 1950, but not in sufficient quantity to substantially offset the can-curtailment order. But even if bottles were available in sufficient numbers brewers would still be faced with a serious, expensive, and time-consuming conversion problem in resuming the bottling of beer to replace their former can-beer business.

On the other hand, if beer sales had increased during 1951, as could have been reasonably expected in view of the tremendous increase in consumer disposable income, the Government would have received additional millions in excise taxes. To illustrate, if beer sales, following the issuance of NPA order M-25 on January 26, 1951, had increased as little as 2½ percent, or one-half of the percentage increase of beer sales in January 1951 over January 1950, the Government would have received by the end of the third quarter on September 30, 1951, an additional $10 million.

It is, therefore, reasonable to assume that the can-curtailment order has cost and will cost the Federal Government through the third quarter of 1951 a minimum of $30,000,000 in beer excise taxes. And if the 6-percent decrease in beer sales in June continues at the expected accelerated rates during the third quarter, the loss in beer excise-tax revenue to the Federal Government may approximate $50 million.

In view of the importance to you, the Congress, and the American taxpayers in obtaining the additional revenues necessary to finance our expanded national defense, may we express the hope that the Senate Finance Committee will adopt a resolution similar to that adopted by the House Ways and Means Committee. We believe that the adoption of such a resolution would cause Government agencies to become more tax-conscious in the issuance of orders which affect Government revenues.

If the committee should have any hesitancy in adopting such a resolution, perhaps the committee might be willing to consider the advisability of requesting Mr. Carroll E. Mealey, Deputy Commissioner in charge of the Alcohol Tax Unit of the Bureau of Internal Revenue to obtain first-hand information as to the effect of the can-curtailment order upon beer excise-tax revenue. Mr. Mealey supervises under Treasury Department regulations the operations of all breweries. To assist him he has district supervisors and field agents conveniently located near breweries throughout the United States. Mr. Mealey can use these assistants to obtain personally from each brewery precisely the effect the can-curtailment order has had on the operations of the brewery. Mr. Mealey could report the results of his investigation to the committee when it is considering the tax bill in executive session.

In 1941 you agreed with our position before this committee that the point of diminishing returns in beer excise taxation had been reached. You, therefore, declined to accept the Treasury's recommendations for an increase in the beer excise tax at that time. In the interest of our national defense during World War II we accepted a temporary increase of $1 in 1942 and another temporary increase of $1 in 1944. The 1942 temporary wartime increase has since been made permanent, and the 1944 temporary wartime increase is also still in effect.

On this question and at this point we would like to incorporate by reference our testimony before the House Ways and Means Committee and the Senate Finance Committee on the revenue revision of 1941. This testimony indicates that the brewing industry accepted the $1 increase in the excise tax in 1940 to help meet the costs of national defense. Then it was discovered that the $1 increase brought the law of diminishing returns into operation. This $1 increase tax was imposed on July 1, 1940. In the first 6 months of 1940 beer sales increased 1 percent but in the last 6 months of 1940 after the imposition of the $1 increase beer sales decreased 4.2 percent as compared with the corresponding period of 1939. This despite the fact that for the year 1940 consumer disposable income was $74,300,000,000 which was an 8-percent increase over the year 1939. This was also a 15-percent increase over the previous 5 year average of $64,000,000,000 in consumer disposable income.

According to the trend of the previous 5 years beer sales should have increased approximately 15 percent over the 5-year average beer sales of 50,610,000 barrels to about 58,217,000 barrels. In other words, despite this marked increase in income paid to persons in 1940 due to national defense activities, beer consumption in 1940 remained about at the previous 5-year average and was actually less than in 1939 by 1.8 percent.

Since 1940 consumer disposable income has increased about 300 percent while beer sales have increased only about 33⅓ percent or slightly more than 10 percent of the increase in consumer disposable income. Since experience has always indicated that when excise taxes are at the proper rate, the sales of mass consumed commodities follow consumer disposable income, it seems to follow clearly that this committee reached the correct conclusion in finding in 1941 that the law of diminishing returns had become applicable in the matter of beer excise taxation; and accordingly had declined to approve a Treasury recommendation for an increase in the beer excise tax in that year. In view of the tremendous lag in beer sales since 1940 it is quite evident that the law of diminishing returns is even more applicable today than it was at that time.

It is true that tin and steel are needed for defense but tax revenue is also needed. We do not ask for any special consideration for beer. We think though you gentlemen will be interested, as was the House Ways and Means Committee, in seeing to it that the excise-tax revenue is not unduly curtailed in the interest of providing tin cans for use by industries who pay no excise taxes whatsoever.

We know that you have a difficult task ahead of you to raise the tremendous amount of revenue needed for national defense. The brewing industry now, as in the past, is willing to bear its fair share of any necessary increase in taxes. However, we submit that it is not reasonable to unduly burden beer, a basic item in the workingman's daily diet. The brewing industry, represented here at the moment by the United States Brewers Foundation, suggests that corporate and even individual income taxes should be further increased rather than to compel the workingman to pay more in taxes for his beer and thus carry a disproportionate share of the tax burden; a burden which should be borne equally by all taxpayers.

So, in conclusion, let us repeat if we may that beer is a mass-consumed food beverage, essential to the working man particularly in the heavy industries and essential to public and military morale especially in times like the present of great national stress; that any increase in the tax will be an indirect retail sales tax which will fall most heavily on the low-income group; that the two wartime emergency increases of $1 each, which we voluntarily agreed to accept in the interest of our national defense, are still in effect; and that the law of diminishing returns in beer excise taxation is even more applicable today than it was when this committee found it to be so in 1941.

Thank you.

Senator BYRD. Our next witness is Mr. Heymsfeld.

Mr. Heymsfeld, the Chair understands that you are going to make a more elaborate presentation than some of the other witnesses. That being the case, we will allow you 20 minutes.

STATEMENT OF RALPH T. HEYMSFELD, GENERAL COUNSEL AND DIRECTOR, SCHENLEY INDUSTRIES, INC., AND VICE PRESIDENT, DISTILLED SPIRITS INSTITUTE

Mr. HEYMSFELD. Thank you, sir.

My name is Ralph T. Heymsfeld. I am general counsel and a director of Schenley Industries, Inc. I am a vice president of the Distilled Spirits Institute, and appear here today representing the institute. The Distilled Spirits Institute is a trade association whose members constitute over 85 percent of the distilled spirits industry.

We, in the last 5 or 6 weeks, have attempted to summarize a vast mass of statistical and factual data which we think would be significant to a consideration of this case, and it comes to about 17 pages.

Now in view of the pressures which we understand are on the committee, I will not endeavor to read the statement in full, but simply to point out what we consider are the most significant parts of the statement although, as I have said, the statement itself is a distillation of a large amount of material, and we hope it will all receive the attention of the committee.

Since the time when the Treasury first advocated the increase in Federal tax, the official estimates of revenue collections——

Senator BYRD. Do you want inserted into the record what you omit?

Mr. HEYMSFELD. Yes, sir. I have handed it to the reporter.

Since the time when the Treasury first advocated the increase in Federal tax, the official estimates of revenue collections on distilled spirits have consistently declined, and I would like to call attention to the table which we have on the first page of our statement, which indicates that the Treasury, on February 5, estimated that $1,750,000,000 of revenue would be derived by the $9 rate.

The Ways and Means Committee, on June 18, came down to $1,650,000,000 and, on June 28, the Treasury came down to $1,565,000,000.

On June 18, the Ways and Means Committee estimated that at the $10.50 rate, the return in revenue would be $1,828,000,000. The Treasury cut this estimate, on June 28, by $108,000,000.

It is interesting to note that the Treasury estimate of what the $10.50 rate will produce, that is, a total of $1,720,000,000 happens to be $30 million below its February estimate of what would be produced at the lower present rate of tax.

It is apparent that the Treasury, since February, has substantially reduced its estimates of the amount of money which the American people will spend for legally distilled spirits. It has revised its estimates downward, notwithstanding an increase of $3,412,000,000 in the Treasury's estimate of disposable personal income.

I think that is significant because, as I shall come to in a moment, the Ways and Means Committee anticipates that because of increases in disposable personal income we can anticipate very substantial increases in distilled-spirits consumption. That, I may say, is the Ways and Means Committee's attitude on this tax, and a good deal of material which is in this statement is intended to show why in our judgment that is not so. It is not so historically and it is not so in the light of the present situation.

Senator KERR. Is it your position that the actual consumption has been far less than the estimated consumption?

Mr. HEYMSFELD. Yes, sir. The actual consumption has been less than the estimated consumption and, as a matter of fact, in the last 3 months, the Treasury receipts show a decline of $81,000,000 as we show by a table on page 4 of this statement.

Senator KERR. Is it your position that that decreased consumption has been caused by increased taxes?

Mr. HEYMSFELD. Yes, sir. It is our position that since 1946, when the bootlegger was again able to go back into business—in 1946 the bootlegger was rather seriously restricted——

Senator KERR. You do not think it might have been because the folks might have gotten smart and quit buying?

Mr. HEYMSFELD. No, sir. We think they bought illegal liquor.

Senator KERR. You think they are buying more over-all, but less taxable?

Mr. HEYMSFELD. We think that is right, and the figures show that conclusively.

The figures of still seizures, the figures of drops in tax revenue, all in the face of the rise of disposable income, figures which show the increase in the capacity of the stills which are in business—and we know that the bootlegger is a pretty smart businessman, and he would not be operating stills that size or operating with that many stills unless he thought he had a market for his product.

When we make something in the legal industry we put it away because we expect that possibly 4 years from now or 5 years from now or 6 years from now there is a market.

Well, it may be that under certain conditions an industry over-produces, but the bootlegger sells his stuff right off the still, and he is not producing the stuff, Senator, unless he knows that he has got a market for it, and, therefore, the size of this bootleg operation, the production end of it, to us is not only an indication of the amount of illegal activity which is going on in this country, but is an indication to us of what the bootlegger, our competitor and the Government's competitor estimates that market is.

He is producing for a market, and when they have all these stills operating, it is because they think they can dispose of the stuff.

But the significant thing is that in 1946, when bootlegging was restricted because the bootlegger could not get sugar, because he could not get copper, when the Government enforcement agents were working with OPA on sugar controls, because it was recognized—and correctly—that that was a means of controlling the illegal production of liquor and still seizures in that year were about a third of what they were between 1939 and 1940, it is an interesting thing that in that year Treasury tax collections reached their peak.

Since that time the bootlegger has been able to get his sugar, he has been able to get copper, he has been able to set up the stills which we referred to—there are 5 or 6 pages of it in this statement, and there could be 50—he has been able to set up these stills, get the raw material to operate them, and while all that has been going on Treasury receipts have been dropping.

Now, to us there is only one conclusion to be drawn from that set of facts.

Senator KERR. That is that the bootlegger is doing more business.

Mr. HEYMSFELD. Yes, sir; the bootlegger is doing substantially more business; that is cutting into tax revenues. It is cutting into

Federal revenues and it is cutting into State revenues, and both, of course, are serious problems.

I would like to refer again to this drop of $81,000,000 which is referred to on page 4 of our statement.

If you will compare the tax collections in April, May, and June of 1951, that is, the current year, with the tax collections of the same 3 months of 1950, there is a drop in Federal revenues of $81,000,000 in those 3 months.

Now, what does that indicate? To us it indicates several things: It indicates, first, that we were correct in saying to the Ways and Means Committee, as we did——

Senator BYRD. I am sorry; I have been called into the Foreign Relations Committee for a few minutes, as acting chairman of that committee. Senator Russell is away.

Senator Williams, will you take the chair until Senator Kerr returns? I will be back in a few minutes.

Senator WILLIAMS (presiding). Go right ahead.

Mr. HEYMSFELD. Senator, I was addressing myself to the table on page 4 of this statement, which shows that in the last 3 months of the current fiscal year—that is, the months of April, May, and June 1951—Treasury collections from distilled spirits dropped $81,000,000. The exact figure is $80,983,591.

That indicates a serious situation, we think, not only for the Treasury but for the industry, and, more importantly, it indicates that we were correct when we told the Ways and Means Committee that the Treasury estimates of what could be derived from this industry by increasing the tax rate were more than a little bit optimistic.

In April tax collections dropped from $76,000,000, a decrease of $29,000,000 from the previous year.

In May they dropped from $110,000,000 to $90,000,000, a decrease of $20,000,000; in June they dropped from $121,000,000 to $90,000,000, a decrease of $31,000,000.

Now, the House report refers to the 1950 consumption of 190,000,000 wine-gallons and uses that as an indication of the fact that because of an increasing rate of consumption in the industry the industry can stand a tax increase without serious effect on its business or on Federal revenues.

Now, the actual fact is that a very substantial portion of those 190,000,000 gallons did not go to the consumer; it went into inventories, because everyone was afraid of a tax increase—they were afraid of possible limitations on production.

In consequence of that, wholesalers, retailers, the State stores, and even the consumer put a little bit extra away, and now we see a devastating effect of that on the revenue collections.

You will note, sir, that the 3 months that we have selected are pre-Korean months. In other words, these are not the months that show this expansion in sales. April, May, and June of 1950 were pre-Korean months.

We also compare those months with 1949, as you might say, a control figure. If you compare 1950 with 1949 you will see that 1950 was running about like 1949.

There was nothing unusual about 1950. But 1951 is very unusual, and we think should give a lot of pause to those who are giving consideration to the possibility that because of all this increased spending there is going to be a vast increase in expenditures for legal liquor.

Senator KERR (presiding). There has been no increase in the tax from 1949 to 1951?

Mr. HEYMSFELD. No, sir. The point that we make, sir, is that the drop which is taking place in 1951 indicates that you cannot give consideration to the 1950 figures in estimating what the American public is going to buy—spend for legally distilled spirits.

Senator WILLIAMS. Do you have those same figures in a comparison for the months of July, August, and September?

Mr. HEYMSFELD. No, sir. We are in the month of July now, and August and September lie ahead, but I may say this, Senator——

Senator WILLIAMS. I mean for last year.

Mr. HEYMSFELD. Yes, in July, August, and September last year as I recall it, there was rather an expansion. We think that in July, August, and September of this year we are going to be possibly even more below last year's figures than we were in April, May, and June 1950.

Senator WILLIAMS. I was wondering as to how much of this April, May, and June might have been a reflection of the advanced buying?

Mr. HEYMSFELD. Well, actually it was not 1950, Senator, because this was pre-Korea.

Senator KERR. He is talking about what happened after June 1950.

Senator WILLIAMS. After June 1950.

Mr. HEYMSFELD. That is exactly the point. In other words, when the Treasury came before the Ways and Means Committee in February and advocated an increase in the tax on distilled spirits, they said, "Look at what it has done; look at what has been happening," and they made these large estimates of what might be sold in the way of legal liquor.

Now, they based those estimates on what happened after Korea.

We said at that time that you cannot count on that. That is what we told the Ways and Means Committee, "You cannot count on this increase," and now the chicks are coming home.

Senator KERR. Do you have a record of what the increase was in July, August, and September of 1950?

Mr. HEYMSFELD. Oh, yes.

Senator KERR. Will you give that to the committee?

Mr. HEYMSFELD. Yes, sir; we will.

(The following was later supplied for the record:)

Federal excise tax collections on distilled spirits, July 1950, $150,034,731; August 1950, $228,569,843; September 1950, $151,800,414.

Senator KERR. Can you give it to us now offhand?

Mr. HEYMSFELD. Well, in the calendar year 1950 tax payments went up, I believe—and I would like to correct this if I am wrong—to about 180,000,000 gallons of tax-paid liquor, which, as you will notice, is a rather substantial increase over the fiscal years 1948, 1949, and 1950 rate.

In 1948, 1949, and 1950 the tax payments were only around 158,000,000 gallons.

Senator KERR. You referred to 150,000,000 wine gallons. Is that a measurement or does that mean of wine or does that mean of all spirits?

Mr. HEYMSFELD. That is a method of measurement. In other words, that is one of the difficult things about this subject, Senator, and that is why it is so hard to put it in a short compass.

There are a lot of technical expressions. Now, when you compute tax gallons you normally mean proof gallons.

A tax is levied on a gallon of alcohol at 100 proof.

Senator KERR. In other words, this tax of $9 a gallon is not on four quart bottles of the finished product?

Mr. HEYMSFELD. It might be, sir.

If you take bottled-in-bond whisky, which is sold 100 proof, the tax actually comes to $9 on those four bottles. It comes to $27 on a case of 12 bottles.

Senator KERR. I see.

If it is other than a 100-proof whisky, then what about it?

Mr. HEYMSFELD. Well, then, the tax per bottle might be——

Senator KERR. More or less.

Mr. HEYMSFELD. It might be in the case you put, except for the addition of the rectification tax of 30 cents a gallon, which is imposed upon blended liquor, and I would say that generally speaking most of the liquor which is sold below a hundred proof is blended liquor and, therefore, subject not only to the $9 tax, but to the 30-cent rectification tax.

As a matter of fact, the Government averages not $9 a gallon, but averages about $9.35 at the present rates for every gallon of liquor which is sold.

Senator KERR. On every gallon by volume?

Mr. HEYMSFELD. No, sir; on every gallon by proof.

Senator KERR. Well, that is all right.

Maybe a continuation of that would only add to my confusion. [Laughter.]

Mr. HEYMSFELD. It is a little on the esoteric side.

Senator KERR. Senator Williams has just called attention to the fact that probably you could not have two members of the committee who would know less about what you are talking about. [Laughter.]

Mr. HEYMSFELD. Well, maybe for the purpose of this being educational, that is a very desirable thing for the industry.

Senator KERR. You could answer my question by just telling me what the $9 is on. It is on that part of the bottle that is a hundred-proof alcohol, or otherwise?

Mr. HEYMSFELD. Well, may I answer your question this way: If you take a bottle of whisky which we sell for $2.50, there is——

Senator KERR. A gallon?

Mr. HEYMSFELD. No, a fifth of whisky, which we sell for, let us say, $2.50, there is $1.63 of tax on that which the Federal Government gets.

Senator KERR. $2.50. Of that $2.50, $1.63 goes——

Mr. HEYMSFELD. Goes to the Federal Government now in tax. We gets 87 cents.

Senator KERR. That is on the average, you are saying?

Mr. HEYMSFELD. That is right, sir.

If you think of a case of 12 bottles, the Federal Government gets in full the proceeds of the sale of 8 of those bottles. They get that net; out of the remaining 4 bottles we have to pay all of the costs of manufacture, State manufacturing taxes, grain, labor, bottles, transportation, that must come out of the remaining 4 bottles.

In other words, the Federal Government now gets, you might say, the gross receipts of the sale of 8 of those 12 bottles, on an average.

Senator KERR. You see, what I started in to find out was what a wine gallon was.

Mr. HEYMSFELD. If you took a gallon measure and filled it without regard to the proof of the product, that would be a wine gallon; in other words, it is a measure.

Senator KERR. Does that mean a gallon by volume?

Mr. HEYMSFELD. Yes, sir.

Senator KERR. Does that mean a gallon by volume?

Mr. HEYMSFELD. Yes, sir; without the proof.

Senator KERR. That is all right.

Mr. HEYMSFELD. I am sorry if I led you astray—I mean far afield. I did not lead you astray, Senator. [Laughter.]

Now, the House report deals with the present situation as though we were back in 1946, and we have in our statement our reasons for thinking that the situation is not at all like 1946.

We have seen that already in this drop that has taken place in the last 3 months in Federal revenue collections. We know that there is not going to be the same shortage in either liquor or soft goods or consumer durables, and we have the word of the Council of Economic Advisers on that subject, and we quote the Council of Economic Advisers which says that what might happen is we may get cut back to 1949 levels.

Well, 1949 levels were not 1946 levels and, as a matter of fact, they feel that because of increasing steel production we might, within some period of time even get back to what they call normal demand levels.

Now, none of this takes account of existing inventory position in all industries which will take up any slack. Also we do not see any comparable increase in purchasing power. We know that real purchasing power has dropped, whereas, in 1946, as compared with the years previous to that, real purchasing power had risen.

But most important of all, and as I said before, and I will not spend too much time on it now, in 1946 you had this real limitation on bootlegging and it was not a law-enforcement limitation alone. It was law enforcement and actual shortage of raw materials.

The bootlegger simply could not operate because he could not get the materials to operate with; and on page 5 of our statement we show that the Commissioner of Internal Revenue, as is stated there, recognizes that fact, and he said in 1949 that the upward trend in internal revenue liquor law violations, as reflected by enforcement statistics was first observed in December 1947, following the abandonment of sugar rationing in June of that year, and he said substantially the same thing in 1950 in his report.

(Senator Byrd assumed the chair.)

What is the significance of that? It again indicates that this drop in legal consumption went hand in hand with an increase in illegal production.

Back in 1933 when the Congress first gave consideration to liquor taxes, they appointed an interdepartmenetal committee to consider the whole problem. It was recognized that there would be many problems.

That interdepartmental committee went into two things, which we think are of great significance at the present time because we think that the gentlemen had considerable provision in what they said.

It was a Government agency that went into the thing very thoroughly, and if you will look back at that report made in 1933 and compare it with what we have today, you can see that they drew a pretty good blueprint of what was going to happen.

Now the first thing they said was that unless you got your tax in order you would bring back the consumption of illegal liquor, and they recommended at that time a $2 tax.

The other thing that they said was—and I refer to it later in this statement—that unless the States and the Federal Government got together on some sensible basis and worked out a joint program of taxation, that the States and the Federal Government, each racing for the maximum amount of revenue from the distilled spirits industry, would hurt the cause of the other.

The House estimates that if you raise the tax from $9 to $10.50 you will get roughly 10,000,000 gallons less consumption.

The Treasury estimated about the same, although it is an interesting thing that if you compare the Ways and Means Committee estimate of what the $9 tax will produce with the Treasury estimate of what the $10.50 tax will produce, you will find a difference of 19,000,000 gallons.

Now the 19,000,000 gallons of drop in sales would very substantially reduce the return to the Federal Government, but more importantly than that, the States would lose revenue on 19,000,000 gallons of legal liquor in addition to having all of the additional enforcement problems which they have to carry.

Senator BYRD. In other words, you would get less revenue with the increased tax; is that your contention?

Mr. HEYMSFELD. Well, the Government departments do not quite get to that point, except if you take the Treasury's estimate of February 5 last year and compare it with the present Treasury estimate, you will find that exactly so. In other words, in February last they said they would get $1,750,000,000 at the $9 rate, and on June 28 they said $1,720,000,000 at the increased rate——

Senator BYRD. Your table on page 4 would indicate a decline. Was that due to the increased tax—on page 4?

Mr. HEYMSFELD. No, sir. That was due to the fact that when people did their buying in the 1950–51 period they were buying because they were afraid of a tax increase. It shows that your 1950–51 figures are not a reliable gage of what consumption should be.

We think that the reliable gage is to take 1948, 1949, and 1950.

Senator BYRD. In other words, it will bring in more revenue, but it is less than the Treasury estimate; is that what you mean?

Mr. HEYMSFELD. Actually, sir, if you should drop from 183,000,000 gallons, which the Ways and Means Committee says you will sell at the $9 rate, if the increase in tax drops us back to what we were actually selling in 1947, 1948, and 1949, there will be a loss of $67,000,000 in revenue.

The Federal Government will get $17,000,000 less and the States will get roughly $50,000,000 less in revenue, and we do not think that is an improbable set of circumstances because we know when we come to sell those 158,000,000 gallons that we were selling the consumer in those 3 years, at the $9 tax, that the consumer is going to have to pay $300,000,000 more for those 158,000,000 gallons than they paid in 1948, 1949, and 1950. Even give us a little credit for the increase in disposable income contrary to what the facts show, and let us say that bootlegging is kept under more control than what we think it can be, even on that basis, if we take the Ways and Means Committee estimate that we can sell 183,000,000 gallons at the $9 rate, and put against that what we can sell at $10.50, and use as a reliable figure what the past has shown to be reliable, even taking account of the $300,000,000 of extra cost, you get $17,000,000 less revenue for the Federal Government, and you get $50,000,000 less revenue for the States. Therefore, this is a very serious problem, not only for the Federal Government and for the industry, but it is a very serious problem for the States, because the States have only one out; the only thing that they can do is increase their tax.

Now, as they increase their tax, they get more enforcement problems, the Federal Government gets more enforcement problems, and there is just no end in sight.

Recently a Senate committee reported out S. 1146. The Committee on Expenditures in the Executive Departments reported out S. 1146, which is a bill intended to create a bipartisan commission which is supposed to go exactly into this problem, and in our view no greater service could be rendered to the Federal Government or the State governments or the industry than to go into that problem seriously, because you must consider, sir, that the increase which is now proposed by the Federal Government is about equal to the average rate of tax which the States charge. In other words, the States have shown a little bit of restraint. Their average is about $1.63. Now, we are talking about adding $1.50 at the Federal level. In other words, we are talking about doubling in effect every State tax in the Nation.

In order to achieve a little objectivity about it, suppose instead of thinking about the Federal tax, we sat here and considered what would happen if every State in the United States doubled its tax, its present tax, and we said to ourselves, What is likely to happen? I think we would only come to one conclusion about it, and that is, that more and more people would be driven out of the purchase of legal liquor and would have to begin buying the bootleg stuff.

Let us look at this bootlegging picture a little bit, because—I have gotten as far as page 13, sir—in this situation, we in the industry, know, and we think the figures prove it, that you have got just as much bootlegging today as you had during prohibition.

That is a serious statement and should not be made lightly. How do we prove it? If you look at the top of page 13, in 1931 and 1932, the Federal Government was seizing 22,000 stills a year.

Now, it just happens that last year the States and the Federal Government together seized about 19,000 stills. Let us discount that to make it easy for ourselves, and let us just take the still seizures by the Federal Government alone. They were 9,000 in number, but how many agents did they have—888 agents?

Now, during prohibition they had 2,212 in 1931, and 2,300 in 1932. In other words, during prohibition the agents were seizing stills at about a rate of 10 a man. At the present time the 888 agents are seizing at a rate, we might say, of 11 a man.

Senator KERR. If they could obtain a few more hundred, then the rate per man would continue.

Mr. HEYMSFELD. There is just no question about it. If they increased the number of agents they would increase the still seizures because these fellows are right back in business. I mean, every year you see your seizure rate going up and up and up and, as I said before, these fellows are not going into this business for the sake of law evasion, they go into this business because there is a market for their product.

If you looked at an industry and you said that that industry has this and this capacity, in this case the bootleg capacity which is 200,000 gallons a day, in excess of the daily production of the legal industry.

Now, let us think of these bootleggers as businessmen, and they have set up a production capacity, and we are talking only of the stills which are seized that we know about.

Senator BYRD. Do they actually produce that much? They may have the capacity to produce it, but——

Mr. HEYMSFELD. Well, sir, there is this amount of guesswork: We do not know how many stills are actually in operation. During prohibition, General Andrews said there were 10 in operation for every 1 seized, but we say just let us take the stills which we have seized and let us see what those stills would have produced in a single day.

When these fellows set up these stills they have got an investment; they have got an investment in copper, they have got an investment in stills, and they have an investment in bribing, possibly, and all the other things that go with illegal activity.

Why do they go into this operation? They go into it because they are going to make money out of it; let us assume that they go into it because they expect to stay in operation for 30 days, which is a very modest estimate, because you have only 888 agents around the United States, and I think any self-respecting bootlegger could expect, if he did the thing cleverly enough, that he should be able to stay in operation some amount of time, but if you just take the actual capacity of the stills which were seized, you have got 200,000 gallons a day more than what the legal industry produced.

I come back to a point that I made before, the bootlegger is producing that not just simply for the sake of law evasion; that is his market research on the subject. He knows he has got a market for that quantity of stuff.

Senator BYRD. Is it your opinion that the bootleggers produce more distilled spirits than all the manufacturing, the legalized manufacturing——

Mr. HEYMSFELD. It is my opinion, sir, that based on these figures that I have collected here, it is entirely possible that the bootlegger is producing more today than the legal rate of sales of the industry.

I do not want to confuse it with production because, as I explained before, we produce for sale a number of years ahead, but there is certainly that possibility at the present time.

Senator BYRD. He produces as much as the consumption from the legalized manufacture?

Mr. HEYMSFELD. Yes, sir.

Senator TAFT. How is it marketed?

Mr. HEYMSFELD. Well, I wish some of the enforcement people would answer that, because our information must of necessity be based on hearsay and on what we read in the newspapers, but there are a number of methods of marketing.

It is a big-scale operation. Trucks are used. Part of it is sold in speak-easies. We understand that the stuff is ordered around industrial plants.

If you will look, Senator, at page 15, Federal officials in April 1949 estimated that in Philadelphia "as a daily average about 5,000 gallons of 180-proof alcohol is being manufactured in the Philadelphia metropolitan area."

Now that is a business of $125,000 a day, just in Philadelphia, and it comes—we did a little arithmetic—here to $15 per capita.

Senator BYRD. What does the bootlegger sell his liquor for?

Mr. HEYMSFELD. Well, that is covered in this statement. The Federal officials, as quoted in the Philadelphia Enquirer say that the bootlegger who pays $25 for a 5-gallon can of alcohol can cut that four times and get 160 pints at a dollar a pint or better a pint, and make a seven-times profit.

Now, we have got this former Federal enforcement agent in Nashville, Tenn., who incidentally—that is on page 15—said that there were a thousand persons engaged in the moonshine-liquor traffic in Nashville, and he said there were several more thousand employed part time. In other words, this illegal industry furnishes full-time employment for a thousand people, says this man, around Nashville, and part-time employment for several thousand more.

That is more employment, I think, than we furnish in that area. He said that the cost of a half pint of straight legal wihsky is roughly equivalent to the cost per gallon of straight moonshine of the cheapest grade. In other words, you can buy a gallon of illicit stuff for the price that you have to pay for a half pint of legally distilled liquor which pays its taxes, and pays its employees, and does the things that any decent industry would be doing in the operation of its business.

Senator KERR. What does the half pint of straight legal whisky on the average sell for?

Mr. HEYMSFELD. Well, a half pint of straight legal whisky, I would say about a dollar. I would like to correct that if I am wrong.

Senator KERR. Well, it sells that $2 a pint, about $4 a quart.

Mr. HEYMSFELD. I think that is about right.

Senator KERR. Now, then, if that statement is correct, then it is roughly equivalent to his cost per gallon of straight moonshine.

That means straight moonshine is selling at roughly a dollar a gallon.

Mr. HEYMSFELD. That is right, sir, down in Tennessee.

Senator KERR. Down here you indicated it is selling for a dollar a pint.

Mr. HEYMSFELD. Well, apparently in Philadeplhia the cost of doing business is a little higher.

Senator KERR. It would be a lot higher.

Mr. HEYMSFELD. Or possibly——

Senator KERR. If they are selling it by the pint in Philadelphia for what you get a gallon of it for in Tennessee, I would say they are selling it a lot higher, wouldn't you?

Mr. HEYMSFELD. Well, Senator——

Senator KERR. That would be eight times as high.

Mr. HEYMSFELD. Well, Senator, I think that the difference is not quite that much, because he figures $25 for a 5-gallon can of alcohol, which he then cuts four times. That would mean that he would get for his 5 gallons—he would wind up with 20 gallons, which he would sell for $25.

In other words, he does not give the fellow 90- or 100-proof whisky, as we do. That would mean that he would be getting 20 gallons which he would sell for $25, so the differential is a dollar plus in the case of Philadelphia as against a dollar in Tennessee.

I do not know whether there is a kind of a national syndicate which sets these prices, but I am glad you point that out because there is a closer relationship between those prices than I first thought when I saw these figures.

Senator KERR. Then Palmore was talking about one thing, and the Philadelphia Enquirer was talking about another?

Mr. HEYMSFELD. Well, Palmore is talking about Tennessee.

Senator KERR. Evidently he was talking about the product which is taken and cut, rather than the product after it is offered for sale.

Mr. HEYMSFELD. I think they are both talking about the same thing. I would not try to guess, because I have not spoken to the people concerned, but Palmore says a gallon of straight moonshine sells in Tennessee at about a dollar a gallon and if you figure out here what price the bootlegger in Philadelphia sells a wine gallon, to get back to the thing we were defining before——

Senator KERR. I wish you would stay off that.

Mr. HEYMSFELD. For something over a dollar a gallon. In other words, he winds up with 20 wine gallons for $25, which is a little over a dollar a gallon.

Senator KERR. Well, the Enquirer is talking about alcohol: He said $25 for a 5-gallon can of alcohol.

Mr. HEYMSFELD. That is right, sir, which he then cuts four times before he sells it.

Senator KERR. This fellow here is talking about straight moonshine.

Mr. HEYMSFELD. That is right. I do not know what the proof of what passes for straight moonshine is in Tennessee.

Senator KERR. Well, it is not straight alcohol.

Mr. HEYMSFELD. That is right. And that is why there is some comparison between these figures.

Now, this rate of tax, we feel, has been responsible for the situation that we confront. We feel that we are entering the area, not only of diminishing tax returns, as I tried to show in the early part of my statement, but we are entering the era of prohibition, and just to get another definition on the record, by prohibition, we mean prohibition on legal sale.

We do not mean prohibition on consumption, because there is no such thing that has ever been known in this country. Eighteen years after repeal, purchasers of small and modest means have already been deprived of the benefit of repeal, and we have entered the area of prohibition by taxation.

Now, England accomplished that job. They did it over a period of about 12 years. In 1920 they got the tax up to a point where everybody but the very wealthy class was driven out of the market for distilled spirits.

Senator BYRD. What was the tax in England? What is it now?

Mr. HEYMSFELD. Well, the tax that accomplished that in England was a tax of 72 shillings and 6 pence, which came to $12.88 at the then rate of exchange.

Then, as a result of imposing that tax, they reduced their consumption down to 0.29 gallon per capita, which was one-half of the 1920 rate, and that was accomplished in a 12-year period.

Now, the present consumption of 0.25 gallon per capita is just what we had in legal consumption in this country during prohibition.

Senator KERR. Wait a minute.

Mr. HEYMSFELD. Sir?

Senator KERR. You say during prohibition we had an average consumption of 2.59 gallons of legal——

Mr. HEYMSFELD. That is right, by medicinal permit, and then we had a vast consumption of illegal. I am indicating what 0.259 means. It is about the per capita consumption; that is, what we sold under medicinal permits.

Senator KERR. So, 2.59 means an average per capita consumption?

Mr. HEYMSFELD. That is not quite right.

Sentator KERR. That is an interesting observation. The average consumption is 2.59 gallons?

Mr. HEYMSFELD. No, sir.

Senator KERR. And that means an average consumption is a third of a gallon.

Mr. HEYMSFELD. No, sir. 0.259 gallon; in other words, 0.259.

Senator TAFT. Twenty-six one-hundredths?

Mr. HEYMSFELD. Right. It is roughly twenty-six one-hundredths.

Senator TAFT. It is a little more than a fourth——

Mr. HEYMSFELD. Just slightly more than a fourth of a gallon per capita.

Senator BYRD. When you speak of per capita, you include everything, women and children?

Mr. HEYMSFELD. Yes, sir. Not that they consume that, but here we have to have some population to measure these figures against. I mean you can draw your figures on the basis of population of over 21 or any other basis. We took this as a general rule.

Senator TAFT. There are people who take quite a bit.

Senator BYRD. What is the consumption in the United States?

Mr. HEYMSFELD. In the United States it is something over a gallon per capita which is what it was in 1910, about 1910, in England.

Senator BYRD. And a fourth of a gallon during prohibition by the prescription liquors.

Mr. HEYMSFELD. Yes, sir.

Now, it dropped a little below that in some years, but there was at least 1 year in which I recall the consumption, the legal consumption, was just about that.

In other words, they have achieved prohibition in England, but prohibition for whom? Not prohibition for everybody, because they still derive a revenue from the sale of distilled spirits. Now, we know who is buying there. It is the very wealthy class, and that is exactly what is being accomplished in this country, that people of lower income, just as the Interdepartmental Committee said in 1933 would happen, and just as the Commissioner of Internal Revenue said in 1949 and 1950 is happening in this country, that through these taxes people of low incomes are being driven to the bootlegger. That is where they are taking this business to, because they can get a gallon of liquor there for the same price that they would have to pay for a half pint of legal liquor brought through the legal channels.

Senator KERR. I do not understand that at all. You say that the bootlegger sells his stuff for a dollar a pint, is that right?

Mr. HEYMSFELD. No, sir; a dollar a gallon.

Senator KERR. You said he paid a dollar a gallon, that is what you said. You said the bootlegger paid a dollar a gallon, and that he cut it so many times and sold it for a dollar a pint and that, therefore, made a profit of 700 percent, is not that what you told us a while ago?

Mr. HEYMSFELD. I am afraid under this feeling of time pressure, Senator, I have moved a little bit fast. We have two places that we were drawing comparisons about, and both of them were based, so far as I am concerned, on hearsay, although the source of the hearsay is set forth in the statement.

Senator KERR. You set forth here——

Mr. HEYMSFELD. We were comparing Tennessee, a statement by an enforcement officer in Nashville, Tenn.

Senator KERR. All right. Here is the Philadelphia Enquirer that you quoted, and you do quote——

Mr. HEYMSFELD. That is right.

Senator KERR. The bootlegger who pays $25 for a 5-gallon can of alcohol.

Mr. HEYMSFELD. That is right, cuts it four times.

Senator KERR. Now that is $5 a gallon that he pays.

Mr. HEYMSFELD. Then he cuts it four times.

Senator KERR. Let us take it step by step.

Mr. HEYMSFELD. That is right, sir.

Senator KERR. The bootlegger pays $5 a gallon——

Mr. HEYMSFELD. That is right.

Senator KERR. For the straight alcohol.

Mr. HEYMSFELD. But the gallon he purchases, is not the gallon he sells.

When he comes to sell those gallons have become 20 gallons, and that is what that statement said. He cuts it four times; in fact, it has become 25 gallons under one interpretation.

Senator KERR. If he cuts it, as this says, four times.

Mr. HEYMSFELD. Well, he gets at least 20 and it may be 25; I do not know.

Senator KERR. You mean if he cuts it four times that may mean five times?

Mr. HEYMSFELD. No, sir.

Senator KERR. I am just taking your quotation.

Mr. HEYMSFELD. He cuts it four times.

Senator KERR. Let us just stop right there.

Mr. HEYMSFELD. What I say is the statement that he cuts it four times is a little ambiguous.

Senator KERR. You say the bootlegger cut it.

Mr. HEYMSFELD. That is right. It might mean that he cuts it either to 20 or 25, but we will take the lower figure. He cuts it to 20 gallons.

Senator TAFT. Let us wait a minute. It seems you are confused. Who does he pay? He pays another bootlegger, presumably the one who makes it.

Senator KERR. The still operator.

Senator TAFT. He pays the still operator.

Mr. HEYMSFELD. That is right.

Senator TAFT. And he pays a dollar a gallon for it.

Senator KERR. No; he pays $5.

Senator TAFT. Wait a minute. You say it costs—what does it cost him, to begin with?

Mr. HEYMSFELD. According to his statement, Senator——

Senator TAFT. I do not care about his statement. What does it cost to make a gallon of whisky? He can make it for a dollar a can, can he not?

Mr. HEYMSFELD. Yes, sir.

Senator TAFT. Anyone with a still can make it for a dollar a gallon, can he not?

Mr. HEYMSFELD. Yes, sir; presumably.

Senator TAFT. And presumably he makes a profit when he sells it to the bootlegger—the distributor—who cuts it.

Mr. HEYMSFELD. That is right.

Senator TAFT. And the distributor cuts it, usually, or does the original still owner?

Mr. HEYMSFELD. Apparently in Philadelphia he does, or did in 1949.

Senator TAFT. He pays $25; he pays somebody for it?

Mr. HEYMSFELD. That is right. We will say that he pays that to the still operator. He pays him $25 for 5 gallons. When he sells it the 5 grow to 20 by the addition of water.

Senator BYRD. The market varies over the country, does it not?

Mr. HEYMSFELD. Oh, yes.

Senator BYRD. Some places they pay more, much more for it.

Mr. HEYMSFELD. That is right.

Senator TAFT. You take a quart, for which you pay $3.65 or $4. Of that quart, $2.25 is taxed, is it not, a straight tax?

Mr. HEYMSFELD. Roughly, that is right, sir.

Senator TAFT. That may be an accumulated profit on the tax.

Mr. HEYMSFELD. That is right.

Senator TAFT. But of it $2.25 is a tax, so that in selling a quart, at least he saves $2.25.

Mr. HEYMSFELD. Of that there is no doubt.

Senator TAFT. He can sell it at all the same margins that the legitimate dealer gets, for $1.40 a quart, or something of that sort.

Mr. HEYMSFELD. Well, we have a figure of $10.57, a very conservative estimate of his saving.

Senator TAFT. $10.57 on what?

Mr. HEYMSFELD. A gallon.

Senator TAFT. A gallon?

Mr. HEYMSFELD. That is what he saves on tax alone.

Senator TAFT. On tax alone. I do not see what difference it makes. The only question I have is whether it is any worse with respect to $12 than it is with $9. You have now already reached a point where the only thing you can do about it is by enforcement anyway.

Mr. HEYMSFELD. We think there is a great deal to be done about it.

Senator TAFT. That is what it appears like to me.

Mr. HEYMSFELD. Keeping your tax in line, because every student of the subject has agreed that is one method of doing it, because what happens is this——

Senator TAFT. You mean he makes such a tremendous profit on $9 that he can make an equal profit on $12. The only thing you can reduce the market for legitimate liquor—some of the people who do not buy it, will do without, and some people will buy bootleg liquor.

Mr. HEYMSFELD. That is it exactly. Every time you reduce the price it is not only a question of the bootlegger's profit, but it is a question of how many more people drop off from the legal into the illegal market, just like under classic economics there is a point at which manufacturers stop producing.

Senator TAFT. If you raised the price and stopped the bootlegging, you still will cut the consumption, and presumably at some point you will actually cut the tax.

Mr. HEYMSFELD. Yes; and we estimate that if—I do not know whether you were here——

Senator TAFT. So that fewer people will buy it, apart from this bootleg question?

Mr. HEYMSFELD. We estimated—and I will repeat this point, if I may—if we succeed in this tax increase, with the $300,000,000 of extra cost which the public would have to pay because of the increase in tax, if as a result of that tax increase we dropped the market from the 183,000,000 gallons which the Ways and Means Committee estimate at $9—if we drop that back to the actual level of the legal market that we had in 1947, 1948, 1949, and 1950, the Government would lose tax in the amount of $17,000,000 a year and the States would lose about $50,000,000 a year.

I would like to take just 1 minute, if I may, sir, to talk of that State tax situation, showing how that operates.

Senator KERR. I would like to ask just one question, if I may, if the Senator is through.

Senator TAFT. Sure.

Senator KERR. I just want to call attention to the fact in your statement—and I am very much interested in your problem—but I want to call attention to the fact that your statement is that this has brought about a situation where the consumer pays as much for a half pint of legal whiskey as he does for a gallon moonshine, and that is not substantiated by the statement, because your statement here indicates he pays a dollar a pint for this bootleg whiskey—that is in the quotation that you give from the Philadelphia Inquirer——

Mr. HEYMSFELD. That is right.

Senator KERR. That the consumer pays a dollar a pint——

Mr. HEYMSFELD. That is right.

Senator KERR. For the moonshine.

Mr. HEYMSFELD. That is right.

Senator KERR. According to your statement, he would not pay any more than a dollar for a half pint of legal whiskey.

Mr. HEYMSFELD. Well, Senator, I am willing to——

Senator KERR. Therefore your conclusion that he pays as much for a half pint of legal whiskey as he does for a gallon of moonshine is inaccurate or the statement is inaccurate.

Mr. HEYMSFELD. No; I was quoting the relationship of a half pint to a gallon. I was quoting Mr. Palmore who said that in Tennessee the cost of a half pint of straight legal whisky—I do not want to appear before this committee as an expert on what it costs a bootlegger to make whisky—I mean, we have got to get this information by hearsay—apparently the costs vary sectionally.

Senator KERR. Yes, but Palmore, if he points out that a half pint of straight legal whisky is roughly equivalent to the cost per gallon of straight moonshine——

Mr. HEYMSFELD. Yes, sir.

Senator KERR. Then what he is doing is saying that the retail price of a half pint of whisky to the consumer is the same as the production cost of a gallon of the cheapest grade of moonshine whisky to the still operator who makes it. He cannot be comparing the cost to the consumer.

Senator TAFT. Won't the cost to the consumer be whatever the traffic will bear?

Senator BYRD. It will vary throughout the country.

Senator TAFT. Whatever the price of legal liquor is, they will sell it under the price of legal liquor, and take the profit.

Senator BYRD. It the hazards are there, if the agents are active; the price of it would depend on a number of things.

Mr. HEYMSFELD. There is no doubt it.

Senator BYRD. There is no standard at all.

Mr. HEYMSFELD. No; but actually the fact that bootleg whiskey is being sold indicates that it enjoys a very substantial price advantage.

Senator BYRD. If you have a prohibition agent active and he is arresting people , and putting them in the penitentiary and all that, then the price of bootleg liquor should go up. But where they are careless about it and not doing anything, and the risk is less probable, then it would be less; is that not correct?

Mr. HEYMSFELD. That is exactly right.

But Westbury, Long Island, Senator, which I happen to know, is not in the mountains, because it is just a few miles from home——

Senator BYRD. The point I am making, there is no standard price at all of bootleg liquor.

Mr. HEYMSFELD. That is right. Here is a 2,500-gallon still seized in Long Island, an operation which used seven vats, each 8 feet wide and 14 feet deep. We figured out that was larger than the smallest legal distillery operating in the industry. That is seven vats, each 8 feet wide and 14 feet deep.

In answer to your question as to how long these fellows operate, the agent says these stills had been operating for months, but the neighbors said they had been smelling what they thought was wine for home use since last summer, which would make it an operation of almost a year, and that still was operating right in Long Island, just outside New York City.

That is not a small mountain still.

I would like to take one moment on this question of costs, and then I will have finished, and I am appreciative of the time I have gotten.

Both the Ways and Means Committee and the Treasury estimate that this tax can be passed on to the consumer without mark-up.

Now, gentlemen, any estimates which are made on that basis cannot be correct.

Senator BYRD. You are speaking of the dollar and a half extra tax?

Mr. HEYMSFELD. That is right. You take the State of Pennsylvania, for example, where the State operates its own liquor stores, in that State a $1.50 tax increase becomes $2.44 by the time it reaches the the consumer, and that is a State operation.

In Vermont, a $1.50 increase becomes $2.10, and we have listed in a footnote on page 6 what these mark-ups are in these various States.

Now, similarly in the industry——

Senator BYRD. Is that because the States add an additional tax?

Senator TAFT. Yes, sir.

Mr. HEYMSFELD. Yes.

They add what they call a mark-up, and these States make $5 a gallon when they sell it, and to get back to the other point, that is the amount of their loss on every gallon that was not sold on the increase in the tax.

Senator TAFT. What is Ohio; do you have it?

Mr. HEYMSFELD. Yes, sir.

Ohio is 42.85 percent.

Senator TAFT. Mark-up, you mean?

Mr. HEYMSFELD. Yes, sir; just under 43 percent.

Senator TAFT. How do you mean?

Mr. HEYMSFELD. That is——

Senator TAFT. A $1.50 increase in tax will be $2.25?

Mr. HEYMSFELD. That is right; something under Pennsylvania.

Senator BYRD. What about Virginia?

Mr. HEYMSFELD. Virginia, 40 percent.

You see, that is what happens in one-third of the Nation in monopoly States.

Senator BYRD. That 40 percent pyramids on the tax.

Mr. HEYMSFELD. That is right, sir; that pyramids on the tax and, therefore, when you come to estimate how much the people are going to spend and then translate that into gallons, you cannot just take the amount of this tax.

You have got to take the amount of the tax plus this mark-up; in other words, you cannot estimate that the fellow is going to have to spend $1.50 a gallon extra.

In Pennsylvania he spends $2.44 more per gallon.

Senator BYRD. In Virginia the State operates its own stores.

Mr. HEYMSFELD. That is right, sir; as they do in Pennsylvania.

Senator BYRD. And that $1.50 tax would be a 40 percent mark-up?

Mr. HEYMSFELD. That is right, according to the present law.

Now, when you get to these private license States you will find that in six of them they actually have put laws on the books defining what the mark-up must be.

In other words, while you have got a private industry operating, the mark-up is fixed by statute.

Senator BYRD. Let me get this straight. In other words, the Federal tax is included in the cost of the product; it is added to the cost of the product, and the mark-up is on the total?

Mr. HEYMSFELD. That is right.

Senator BYRD. Does every State in the Union do that, or not?

Mr. HEYMSFELD. Here is how it breaks down. There are these 17 monopoly States. Then there are six States which have a mark-up which is prescribed by law. In other words, the same results substantially are accomplished. But beyond that, and as I think will appear from the testimony of later witnesses, this industry, which took on the 1944 war tax without a mark-up, because they thought it was a temporary emergency measure, has been facing steadily increased costs, and to expect that they will carry this tax increase without mark-up is just to consign a percentage of that industry to bankruptcy.

Now you have got sales taxes in 31 States, and they are levied on a percentage basis, so you have got an automatic increase in cost.

We made a rough guess on page 7 of this statement that the cost of a $10.50 tax on 158,000,000 gallons would be $300,000,000.

In other words, if we found that much extra purchasing power in the consumer, $300,000,000 extra and sold him what we sold him in 1948, 1949, and 1950, we would lose, as against the Ways and Means Committee estimate of 183,000,000 gallons which they say we can sell at the $9 rate, we would lose $17,000,000 of excise revenue to the Federal Government—I will not mention the corporate and personal income taxes—and then the States would lose on that number of gallons we estimate, roughly, $50,000,000 as we view this situation.

Senator BYRD. There would be purchase resistance because of the price increase.

Mr. HEYMSFELD. That is correct, sir.

So, as we estimated, there are $67,000,000 in revenue lost, without taking into account the increased enforcement problems which the tax will create.

Senator KERR. Mr. Chairman, I would like to introduce into the record at this point a table put in the record in the hearings before the Committee on Ways and Means of the House and found at page 533, which is an exhibit from the Alcohol Tax Unit, Bureau of Internal Revenue, February 21, 1951, showing the mash seizures in the first, second, third, and fourth supervisory districts during the 12-month periods before and after each of the increases in the tax rate on distilled spirits beginning 1938, and which shows that the mash seizures in those four districts have decreased from 1,647,968 gallons in 1938 to 289,521 gallons in 1944–45.

(The document referred to follows:)

Mash seizures in the first, second, third, and fourth supervisory districts during the 12-month periods before and after each of the increases in the tax rate on distilled spirits beginning with 1938

[Gallons]

Supervisory district	Increase in rate from $2 to $2.25 on July 1, 1938		Increase in rate from $2.25 to $3 on July 1, 1940		Increase in rate from $3 to $4 on Oct. 1, 1941		Increase in rate from $4 to $6 on Nov. 1, 1942		Increase in rate from $6 to $9 on Apr. 1, 1944	
	Mash seized July 1, 1937–June 30, 1938	Mash seized July 1, 1938–June 30, 1939	Mash seized July 1, 1939–June 30, 1940	Mash seized July 1, 1940–June 30, 1941	Mash seized Oct. 1, 1940–Sept. 30, 1941	Mash seized Oct. 1, 1941–Sept. 30, 1942	Mash seized Nov. 1, 1941–Oct. 31, 1942	Mash seized Nov. 1, 1942–Oct. 31, 1943	Mash seized Apr. 1, 1943–Mar. 31, 1944	Mash seized Apr. 1, 1944–Mar. 31, 1945
District No. 1 (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont)	137,623	[illegible]	88,586	[illegible]	31,457	20,882	20,452	9,650	9,262	12,970
District No. 2 (New York)	810,756	852,706	711,454	690,888	722,577	356,922	321443	169,659	167,153	141,640
District No. 3 (Pennsylvania)	230,279	[illegible]	165,181	118,752	77,111	41,252	39,944	1,448	30,918	24,295
District No. 4 (Delaware and New Jersey)	469,310	846,956	[illegible]	279,982	277,734	74,221	49,711	24,110	108,693	110,616
Total (4 districts)	1,647,968	1,971,79[illegible]	[illegible]	1,125,164	1,108,879	493,277	431,550	204,867	316,026	289,521

Source: Alcohol Tax Unit, Bureau of Internal Revenue, Feb. 21, 1951.

Mr. HEYMSFELD. May we have permission, Senator, to carry those figures up to date because those figures go from 1944 to 1945?

Senator KERR. Yes.

Senator BYRD. I think the figures should show the number of prohibition agents.

Mr. HEYMSFELD. We would like permission to file it if you would like to have it.

(The information referred to follows:)

In answer to inquiry by Senator Byrd, Mr. Dwight E. Avis, Assistant Deputy Commissioner, Alcohol Tax Unit, Bureau of Internal Revenue, advised that there were 850 investigators in the Alcohol Tax Unit at present time.

Mr. HEYMSFELD. I submit my complete statement for the record.

Senator BYRD. Your statement will be put in the record.

Mr. HEYMSFELD. Thank you, sir.

(The prepared statement follows:)

STATEMENT OF RALPH T. HEYMSFELD, GENERAL COUNSEL, DIRECTOR, SCHENLEY INDUSTRIES, INC., AND VICE PRESIDENT, DISTILLED SPIRITS INSTITUTE

My name is Ralph T. Heymsfeld. I am general counsel and a director of Schenley Industries, Inc. I am a vice president of the Distilled Spirits Institute and appear here today representing the institute. The Distilled Spirits Institute is a trade association whose members constitute over 85 percent of the distilled-spirits industry.

H. R. 4473 proposes an increase to $10.50 in the tax on distilled spirits. This would add $1.50 a gallon to the $9 war tax enacted in 1944. How much, if any, additional revenues will this produce?

THE DECREASING OFFICIAL REVENUE ESTIMATES

Since the time when the Treasury first advocated the increase in the Federal tax, the official estimates of revenue collections on distilled spirits have consistently declined. These are the estimates:

	Estimated revenue	Estimated tax-paid gallons
	At $9	
Treasury (Feb. 5)	$1,750,000,000	194,000,000
Ways and Means Committee (June 18)	1,650,000,000	183,000,000
Treasury (June 28)	1,565,000,000	174,000,000
	At $10.50	
Ways and Means Committee (June 18)	$1,828,000,000	174,000,000
Treasury (June 28)	1,720,000,000	164,000,000

The Ways and Means Committee now estimates $178,000,000 of additional revenues. The Treasury now estimates $155,000,000.

Treasury estimates are that 174,000,000 gallons would be tax-paid at the existing rate and produce $1,565,000,000 of revenue. Under the increased rate, the Treasury estimates 164,000,000 gallons would be tax-paid and produce $1,720,000,000 of revenue.

If we compare this estimate of June 28 with the statement of the Treasury before the Ways and Means Committee on February 5 last, we find that at that time the Treasury estimated that 194,000,000 gallons would be sold under the $9 rate and would produce $1,750,000,000 in Federal revenues—$30,000,000 more than is now estimated for the $10.50 rate.

It is apparent that since February, when it first advocated an increase in the Federal tax, the Treasury has substantially reduced its estimates of the amount of money which the American people will spend for legally distilled spirits. It has revised its estimates downward, notwithstanding an increase of $3,412,000,000 in its estimate of disposable personal income.

The staff of the Ways and Means Committee reduced the original Treasury estimate of sales at the $9 rate by about 11,000,000 gallons and used a figure of

183,000,000 gallons. Now the later Treasury estimate of 174,000,000 gallons has brought the Treasury Department 9,000,000 gallons below the Ways and Means Committee staff.

Both the Treasury and the Ways and Means Committee agree that a tax increase will decrease legal sales. The Ways and Means Committee staff expects that at the $10.50 rate 174,000,000 gallons would be tax-paid; however, the Treasury experts believe that only 164,000,000 gallons would be tax-paid. The difference between the Ways and Means Committee forecast of sales at the $9 rate and the Treasury estimate of sales at the $10.50 rate is 19,000,000 gallons.

The Ways and Means Committee report of June 18 says that the tax increase will not seriously affect the consumption level of liquor because:

"The acceleration of the defense program presents the likelihood that income levels again will rise and consumers again will have to cut down their purchases of durable goods."

This is the main assumption upon which the tax increase is proposed. There is one collateral assumption, that the—

"Financial incentive for illicit operations resulting from the tax increase * * * is likely to be more than offset by a tightening of the labor supply available for these operations and by higher incomes on the part of consumers, which will decrease the importance of the price differential between tax-paid and non-tax-paid liquor."

Of course, if these assumptions were correct, the tax yield would rise substantially without raising the rates. The House estimate of $1,050,000,000 at the $9 rate would, if attained, be an increase of $229,000,000 over the 1950 return—such an increase without increase in rate ought to be highly satisfactory.

THE INDUSTRY'S REVENUE ANALYSIS

The House report deals, at best, with transitory conditions which cannot be the basis for long-range tax policy. It compares the situation with 1946. That too was a temporary situation which soon came to an end and we saw the effects of the $9 tax in the 1948, 1949, and 1950 period when legal sales dropped 30 million gallons per year and Federal revenues dropped $332,000,000 a year.

In the 1933 report of the interdepartmental committee on distilled spirits, it is shown from a review of the preprohibition experience that there is "a marked variation in per capita consumption with changes in general business conditions, and this movement varied from 1.5 gallons in prosperous years to 1 gallon in years of depression."

In 1948 through 1950, under the $9 wartime tax, expenditures for legal spirits did not keep pace with the rise in disposable personal income.

Disposable personal income rose from $158.9 billion in 1946 to $202.7 billion in 1950, but distilled-spirits expenditures did not rise with the increase. The amount spent on distilled spirits in 1946 was 3.18 percent of disposable personal income, but in the following years the ratio dropped each year, even in the year 1950, as follows:

	Percent
1947	2.69
1948	2.07
1949	1.95
1950	1.91

Moreover, we in the industry think the situation differs markedly from 1946:

1. The increased tax payments after Korea, referred to in the House report, are not persuasive because they did not mean an equal increase in consumer purchases, but resulted from scare increases in inventory position. A comparison of the tax collections from distilled spirits for the last quarter of fiscal 1951 with the same quarter of the two previous years clearly reveals this:

Federal tax collections: Distilled spirits excise

	1949	1950	1951	Decrease 1950-51	Percent loss 1950-51
April	$100,272,321	$105,150,140	$76,107,674	$29,042,466	27
May	107,146,468	110,812,047	90,369,597	20,442,450	18
June	107,110,012	121,298,675	89,800,000	31,498,675	25

3 months decline (1950-51) $80,983,591.

The House report refers to the 1950 consumption of 190,000,000 wine gallons. The actual tax collections for the last fiscal quarter show conclusively that the 1950 results did not represent consumption, but increases in inventory position which are now reflected in offsetting decreases in tax revenues.

2. We see no shortage comparable to 1946 in liquors, soft goods, or consumer durables.

The Midyear Economic Report by the Council of Economic Advisers points out that the reduction this year of scarce metals will not reduce consumer durable-goods production more than 30 to 40 percent of the first half of 1950 rate and would permit output near the levels of 1949 (pp. 94 and 95). Expansion of finished steel output in the next few years would, according to the report, "support continued economic growth, residential and public construction on at least as large a scale as in 1950, and the satisfaction of normal demands for consumer durable goods" (p. 84). During the first half of 1951 an excess of inventories developed at the retail level in consumer durable goods particularly (p. 104).

3. We see no comparable increase in real purchasing power.

The Ways and Means report was issued in June. According to the July report on Economic Indicators of the Council of Economic Advisers, issued July 11, disposable personal income in the first quarter of 1951 showed a drop, in terms of 1950 prices, from the last 6 months of 1950. Although dollar income went up, real purchasing power went down. (July report on Economic Indicators, p. 20.)

4. Bootlegging was much more restricted in the year 1946 because of shortages of sugar, copper, and other materials. Only 6,041 stills were seized by the Federal Government in that year and the daily producing capacity of illicit stills seized during the 1946–47 period, was less than one-third of the comparable 1939–40 period.

The report of the Commissioner of Internal Revenue for 1946 says:

"Throughout the fiscal year investigators of the Alcohol Tax Unit and the Office of Price Administration devoted much of their time to the joint program, looking toward the enforcement of sugar-rationing regulations, and the prevention or detection of diversions of sugar into illicit channels or into the black market generally. This program was recognized by the Bureau as the best means, so long as sugar remained under rationing control, of preventing moonshiners from obtaining sugar and is offering an opportunity to disclose incomes received illegally by black-market operators and not reported for income-tax purposes."

Six thousand and fifty-three illicit stills were seized during 1947. Sugar rationing was discontinued at midnight June 11, 1947.

The 1949 report of the Commissioner of Internal Revenue says:

"During the fiscal year 1949, violations of the internal revenue liquor laws, as reflected by enforcement statistics, continued to increase.

"This upward trend was first observed in December 1947, following the abandonment of sugar rationing in June of the same year."

The 1950 report of the Commissioner of Internal Revenue says:

"During the fiscal year 1950 violations of the internal revenue liquor laws, as reflected by enforcement statistics, continued to increase. This upward trend was first observed in December 1947 following the abandonment of sugar rationing in June of the same year. The increase in violations has been confined principally to the Southern States and a few metropolitan areas on the east coast. The underlying reason for the large volume of violations in the Southern States is the preponderance of low-income groups which furnish the demand for cheap spirits, coupled with the fact that more than 40 percent of the population is located in local option counties where tax-paid liquor is not readily available."

The House bill proposes:

(1) The largest tax increase for the alcoholic beverage already carrying the highest rate.

(2) The largest tax increase on the product most subject to large-scale illegal substitution.

We must expect, therefore, some shifts from distilled spirits purchases to purchases of other beverages, as well as greatly increased sales of bootleg liquor.

The Interdepartmental Committee report of 1933 said:

"As prices increase, only the higher-income groups could continue to consume the same quantity, while the lower-income groups would consume less of the legalized product and increase their consumption of wines and illegal liquor."

The House estimates that at the $10.50 tax rate consumption will drop 5 percent, from 183,000,000 gallons to 174,000,000 gallons. Suppose that as a result of the tax increase tax-paid consumption is reduced by 15 percent? A 15-percent reduction would mean that the Federal Government would gain no additional excise revenue from the tax increase, it would lose corporate and personal-income taxes, and the States would lose revenues on 25,000,000 gallons.

Is that a remote possibility? We do not think it is. A 15-percent drop would bring us back to a level of 158,000,000 tax-gallons, which is just about the 1948, 1949, and 1950 rate of sales. If we consider that the added tax costs would make consumer prices substantially higher than the 1948-50 prices, the 158,000,000-gallon figure is on the hopeful side.

The Treasury Department and the House Ways and Means Committee estimates are based on the assumption that the added Federal tax cost can be passed on to the consumer without mark-up. That is not a realistic assumption.

In the State of Pennsylvania, for example, there is a mark-up of 48 percent on the State's delivered cost and there is also a 10-percent emergency tax. A $1.50 increase in tax automatically becomes an increase of $2.44 a gallon to the consumer buying in Pennsylvania.

In the State of Vermont a $1.50 increase in the Federal tax likewise means an automatic increase of $2.10 per gallon at the consumer level.

In these and other monopoly States there is an automatic mark-up on the increase in Federal tax cost.[1]

During the OPA period from 1942 to 1946 when the Office of Price Administration ruled that monopoly States could not take a mark-up on the war-excise rates, several of these States imposed State emergency war taxes. After price controls ended most of these States canceled the State war emergency taxes and marked up all of the Federal tax increases on distilled spirits.

In the license States trade mark-ups are an economic necessity and are now required by law in six States.

Arkansas	By law (amended 1951): Wholesaler must mark up 13 percent; retailer, 30 percent.
Georgia	By regulation: Wholesaler, 14 percent; retailer, 33⅓ percent.
Kentucky	By law: Wholesaler, 15 percent; retailer, 33⅓ percent.
New Mexico	By law: Wholesaler, 17.5 to 18.04 percent; retailer, 33⅓ percent.
Rhode Island	By regulation: Wholesaler, 15 percent.
South Carolina	By law: Wholesaler, 25 percent.

Thirty-one States levy a percentage general sales tax applicable to distilled spirits, and an increase in Federal tax cost is automatically reflected by a further increase in sales price.

The added consumer cost of a $10.50 tax would be over $300,000,000 on 158,000,000 gallons.

We are left, therefore, with this conclusion: If the added cost to the consumer of a $10.50 tax, together with the increase in illegal sales caused legal sales to drop, from 183,000,000 gallons estimated at the $9 rate to the sales level that we had from June 1, 1947, through June 30, 1950, the Federal Government would gain absolutely nothing in added revenues. But the States would lose millions of needed revenues.

THE LOSS TO THE STATES

Neither the Treasury nor the Ways and Means Committee report makes any reference to the effect of a tax increase on the large State revenues from distilled spirits.

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[1] Here is a list of the monopoly State mark-ups:

Alabama	40 percent, then additional 10 percent.
Iowa	40 percent; Iowa Liquor Control Board has legislative authority to establish prices so as to return up to 65 percent gross profit.
Michigan	46 percent.
Oregon	44 percent.
Pennsylvania	48 percent, then additional 10 percent.
Utah	55 percent, then additional 6 percent.
Vermont	40 percent.
Washington	54 percent.
Idaho	63 percent.
Maine	61 percent.
Montana	53 percent, then additional 8 percent.
New Hampshire	40 percent.
North Carolina	50 percent, then additional 8½ percent.
Ohio	42.85 percent.
Virginia	40 percent.
West Virginia	60 percent.
Wyoming	17.6 percent (wholesale monopoly).

In 17 States which have State stores, sales of distilled spirits result in an average of $5 per gallon of gross revenue.

In the State of Vermont, for example, in addition to the mark-up of 40 percent on the State's delivered cost there is added a State excise tax of $3.60 a gallon, making the gross revenues to the State $5.26 a gallon.

In Pennsylvania the State averages $6.10 per gallon.

In the States of Ohio and Virginia the gross return is $3.87 per gallon.

In the remaining States, in which distilled spirits are sold by licensed dealers, the State and local governments collected in 1950 an estimated $300,000,000 of tax revenue from the sale of 131,000,000 tax gallons of distilled spirits, for an average yield of $2.20 per gallon. Excise tax collections averaged $1.48 per gallon and sales taxes $0.15 a gallon.

All of these 28 States impose gallonage taxes, and 17 of these States impose additional general sales taxes which are applicable on the retail selling price of liquor. In addition there are city sales taxes in such cities as Los Angeles, San Francisco, New York, Chattanooga, Baltimore, Atlanta, and Savannah.

Of the total $300,000,000, $194,000,000 was derived from excise taxes and $18,000,000 from sales taxes, and the rest was license fees and miscellaneous taxes in local license fees and local taxes. There were $6,200,000 in miscellaneous taxes.

Thus, the 17 monopoly States would average a loss of $5 for each unsold gallon, and the private license States would lose $1.63 per gallon in sales and excise taxes. Reduced sales volume will drive some wholesalers and retail outlets out of business, affecting license fees, which will increase the loss to above $1.63 a gallon.

THE NEED FOR FEDERAL-STATE COORDINATION

The present Federal tax has had precisely this hurtful effect of depressing consumption and reducing State revenues since 1946. There has, therefore, been continuous pressure in the States to make up the lost revenue by increasing tax rates. This in turn reduces consumption and affects Federal revenues adversely.

In 1949, for example, 23 States and the District of Columbia considered increases in taxes on distilled spirits. Six increases were effected: in the District of Columbia, Florida, Georgia, Massachusetts, Minnesota, and North Dakota.

In 1950 Texas increased its taxes.

In 1951, stimulated, we believe, by the proposal to increase Federal taxes, 21 States considered increases, and in 11 States increases have already been adopted.

Arkansas	Additional 3-percent tax on alcoholic beverage retail sales, making the total 5 percent.
Idaho	Increased the retail price of alcoholic liquor slightly.
Nebraska	Increased the tax from $1 to $1.20 a gallon.
New Mexico	Increased the tax by 10 cents a gallon from $1.20 to $1.30.
Pennsylvania	Made a 10-percent emergency tax permanent.
Rhode Island	Increased the tax by 50 cents a gallon from $1 to $1.50.
West Virginia	Passed a law requiring the State liquor authority to increase the retail price of liquor sold in State stores sufficient to provide $1,600,000 for a veterans' bonus.

Maine, Georgia, South Carolina, and South Dakota have increased their sales taxes.

All of these actions have taken place since the Secretary of the Treasury's proposal to increase the Federal tax. There are other measures pending in legislatures still in session.

In its report to the Secretary of the Treasury on the eve of repeal, the Interdepartmental Committee pointed out that "the coordination of State and Federal taxation of alcoholic beverages" was one of the important problems to be faced postrepeal.

On this the committee said:

"PART IV. THE PROBLEM OF STATE TAXATION

"Control of the price of basic alcoholic liquors to the ultimate consumer by control of the tax burden is not a matter within the exclusive province of the Federal Government. The problem includes a consideration of the coordination of State and Federal taxation. The most careful Federal program can be dislocated by an uncoordinated system of State taxation superimposed upon the Federal system. In the pre-prohibition period the States as a matter of policy did not attempt to tax alcoholic beverages per se, but limited themselves to occupational taxes on its manufacture and sale. These taxes were not generally high enough to have any substantial effect on the price of alcoholic beverages to the ultimate consumer.

"It is to be anticipated, however, that the present need of the States for new sources of revenue will lead to State taxation of alcoholic beverages per se. It is clear that an effort should be made, therefore, to coordinate State and Federal liquor taxation on some basis equitable to both, which will permit the formulation and administration of a reasonably uniform and orderly taxing system."

The special committee of the Congress appointed in 1947 to study State-Federal tax relations recommended as to liquor taxes "the continuation and extension of that general forebearance and due regard for each other's taxes that the Federal Government and the States should practice at all times."

The States, which, under the Constitution, have the responsibility for controlling sale and distribution, have not in any instance attempted to use the taxing power for a prohibitory purpose. State taxation has been solely for revenue—and, although high in some cases, it has in no case come near the extraordinary Federal level. In fact, the proposed Federal increase is in itself almost as high as the average rate of all present State taxation—in other words, the proposed increase is tantamount to doubling the present State rates.

We feel that more revenue will be created by ending the uneconomic race to increase rates which is now going on between the Federal Government, the States, and the municipalities.

On July 12th last the Committee on Expenditures in the Executive Departments reported favorably on a bill (Senate 1146) for the establishment of a temporary Bipartisan National Commission on Inter-governmental relations. One of the duties of this Commission is to submit to the Congress specific recommendations concerning the fiscal relations among the National, State, and local Governments, giving particular attention to "revenue sources and means of reducing or eliminating intergovernmental tax competition."

Senate 1146 proposes a commission that will "go beyond the purely study stage and propose an active program." We believe that the adoption of such a program is of greatest importance to the maintenance of the high level of Federal, State and, local revenues from the distilled-spirits industry.

PROHIBITION BY TAXATION

In 1933 the American people voted the repeal of prohibition. They did so because they wanted to buy distilled spirits of good quality, lawfully, and at reasonable prices. They did so because they wanted to wipe out the bootlegger, whose illegal activities were menacing our entire system of law observance and law enforcement. What is the situation in 1951?

A bottle of whisky which the distiller sells for $2.50 returns $1.63 of tax to the Federal Government and 87 cents to the distiller. Out of this 87 cents the distiller must, of course, pay the cost of grain, bottles, labor, State manufacturing taxes, and other costs, including all corporate taxes. The tax at the distiller's level is equivalent to 200 percent of the distiller's gross sales price. By the time the liquor reaches the consumer, State and local taxes have been added. Federal and State taxes on a case of 12 quarts of 100-proof bonded whisky come to $31.89.

Out of the sale of a case of 12 bottles by the distiller, the Federal Government gets net the entire sales price of 8 of the bottles and the distiller out of the remaining 4 bottles must pay all of the cost of manufacture of the 12. The rate of tax is about 1,000 percent on production costs of the newly distilled product in bulk.

The tax of $9 a gallon is equivalent to a tax of $45 per bushel on each bushel of grain used.

There is no other commodity in lawful commerce carrying such a tax burden.

Eighteen years after repeal, purchasers of small and modest means have been deprived of the benefits of repeal and we have entered the area of prohibition by taxation.

In England, prohibition by taxation was achieved for all but the wealthy in a period of 12 years after 1920.

In 1901 the British tax was 11 shillings per imperial gallon. Consumption was 45,889,000 British proof gallons of whisky, or a per capita consumption of 1.53 gallons.[8]

From 1900 through 1915 the tax was increased twice to 14 shillings 9 pence ($2.62 per United States proof gallon) and consumption dropped 30 percent to below 1 gallon per capita.

The tax was raised to 30 shillings in 1918, to 50 shillings in 1919, and in 1920 to 72 shillings 6 pence ($12.88 per United States proof gallon at then rates of exchange). By 1933, under the $12.88 tax, consumption was down to 0.29 gallons per capita, less than one-half the 1920 rate.

Through high taxation, the consumption of distilled spirits in Britain at the present time has become limited to the very wealthy class. The present tax rate is 210 shillings 10 pence, and present consumption in England (0.25 gallon per capita), is below the 1921 legal rate in the United States (0.34 gallon per capita) while prohibition was in effect and while the only lawful distribution was through permits for medicinal use.

Are we to have a similar history in this country?

In January 1934, a rate of $2 per gallon was imposed by the Congress, following joint hearings before the Ways and Means Committee and the Senate Finance Committee.

The Interdepartmental Committee had been created to study the tax situation, among others, because it was recognized that "the price of legal liquor to the ultimate consumer in the post repeal period" would be a "principal factor in determining the success or failure of the general efforts to eliminate the illegal industry."

The tax agreed upon by the Congress to accomplish this result and to obtain maximum revenues was $2 per gallon. State taxes levied at the same time averaged 66 cents per gallon, making a total of $2.66.

Today State and Federal taxes have risen to an average of $11.57 a gallon: $9.37 of Federal tax and $2.20 of State tax.

BOOTLEGGING AT PROHIBITION LEVELS

Bootlegging today is on a scale comparable to bootlegging at the time of repeal, when the Congress decided that a $2 tax rate was necessary in order to eliminate the illegal industry.

In 1931 and 1932 prohibition Government agents (2,212 in 1931 and 2,300 in 1932) were seizing about 22,000 stills annually, about 10 per man. In 1934, following repeal and the adoption of the $2 tax rate, still seizures dropped to 9,869.

Last year, 1950, Federal and State officials seized 19,644 stills. Federal agents (about 888 in number) seized about 10,000 stills—about 11 per man. The stills seized had a daily producing capacity of 677,000 gallons—about 200,000 gallons a day in excess of the daily production of the legal industry.

The Alcohol Tax Unit reports that in March, April, and May of this year its agents seized 2,918 stills with a daily capacity of 89,701 gallons. For the same 3 months of 1950, ATU agents seized 2,906 stills, with a total daily capacity of 85,489 gallons.

Enforcement agents have been picking up illegal stills at a rate of better than 53 a day. The number of the stills has gone up, and the capacity of the illegal stills has gone up too.

Year after year still seizures grow, even though the number of enforcement agents has gone down. The seizure rate would be even higher if there were more agents operating. Are there 2 stills operating for each one seized—or 5? or 10? No one knows. When General Andrews was Prohibition Commissioner he assumed that for every still that was put out of business by the Government there were at least 10 more that were not discovered.

Both the Federal Government and the States are losing vast sums of money in legal excises. Enforcement is breaking down, and bringing corruption and

[8] All per capita consumption figures are United States proof gallons.

racketeering in its wake. We have achieved a kind of prohibition by taxation, and with it have brought back the bootlegging typical of prohibition.

We can go from State to State for examples.

Georgia is an outstanding example of how high taxes result in bootlegging and lost revenues.

In 1945, the State raised the liquor tax from $1.20 to $4 a gallon.

Georgia revenues dropped from $13.6 million to $10.8 million. The next year they dropped to $9.4 million.

Then in 1949, to offset falling revenues, the tax was raised again—from $4 to $5 per gallon.

But, by the end of 1950, revenues had fallen 55 percent, while seizures of illegal stills in Georgia by Federal agents alone increased 45 percent, from 1,865 to 1,964.

Finally, on April 2 last, on the recommendation of the revenue commissioner, there was a drastic tax reduction from $5 to $2 a gallon.

The results of the tax reduction are striking. Department of Commerce figures show that in April 1951 Georgia had an increase of 92 percent in sales over the previous month, and in May there was an increase of 40 percent over April.

Stamp sales in Georgia in May 1951 were $110,172 as against $83,363 in May of 1950, and were $208,000 in June 1951 as against $123,000 in June 1950.

In Florida, the State beverage department destroyed 1,283 illicit whisky stills in the 1949–50 period. It was estimated that, if stills destroyed had operated for 1 year and their products had been sold, they would have defrauded the State of $30,000,000 in liquor taxes.

Notwithstanding these enforcement efforts, a criminal-court judge sitting in Jacksonville, Fla., said from the bench a few weeks ago:

"Bootlegging in Jacksonville has become big business again. It is robbing the State and Federal Government of millions in taxes and depriving the aged, the blind, and dependent people of a part of their livelihood. Bootlegging is rumored to have joined forces with certain law-enforcement officials who are conveniently elsewhere when trucks loaded to capacity slip into the city to unload their filthy products from the swamps. * * *"

"We saw during prohibition how corrupt officials at first merely closed their eyes to the manufacture and sale of whisky. As rivals made war on each other, murder was overlooked. Jacksonville is closer to a return to these conditions than most of us realize," the judge continued.

"The loss to Florida's State treasury runs into millions each year."

Between 1936 and 1947 the tax burden in South Carolina jumped 840 percent. In the latter year there was imposed a special gross-profits tax. Legal sales dropped from 1,241,163 cases in 1940 to 652,500 cases in 1950.

The July 6, 1951, issue of the Charleston News and Courier points out that, whereas over-all South Carolina tax revenues from all sources hit a record high of over $94 million in the last fiscal year—

"The only thing that's fallen off heavily since 1940 has been liquor-tax rates—these were getting close to $13,00,000 a year when a gross-profits tax put on in 1947 cut them to the present $9,500,000."

The Nashville Tennessean of July 10 reported the State alcohol-tax division as saying that over a thousand persons were engaged in the moonshine liquor traffic in Nashville, Tenn., and several thousand more were employed part time. The director, J. S. Palmore, who happened to be one of the oldest Federal Alcohol Tax agents in point of service in the country when he joined the Tennessee division 8 years ago, is quoted as saying that "people who have consumed no moonshine liquor since prohibition days are drinking it again."

Palmore pointed out that the cost of a half pint of straight legal whisky is roughly equivalent to the cost per gallon of straight moonshine of the cheapest grade. "That gives an idea," he said, "of the tremendous economic factor involved in the switch-over from legal to still-made beverages."

During the calendar year 1950 investigators of the Alcohol Division of the State of Tennessee participated in the seizure of 705 illicit distilleries—yet, the above report is made as of July 1951. On May 23 it was reported that an electric still was seized in Tennessee which was using TVA power.

In Philadelphia, Federal officials estimated in April 1949 (Philadelphia Inquirer of April 6, 1949) that "as a daily average about 5,000 gallons of 180-proof alcohol is being manufactured in the Philadelphia metropolitan area." The "smoke" is cut 4 to 1 to obtain 32 pints, which retail for about $1 apiece. The officials estimated that bootleggers were doing a $125,000-a-day business. If that is true, it amounts to $15 per capita per year. We quote from the Philadelphia Inquirer: "'The bootlegger who pays $25 for a 5-gallon can of alcohol can cut that four times, and get 160 pints at a dollar or better a pint, and make a seven times profit,' the Federal agents said. The reason why they extract such prices is the heavy taxes levied on legal whisky by both State and Federal Governments, it was explained."

Illegal distilling is not confined to any particular area. Mr. Dwight Avis, Deputy Commissioner in charge of enforcement, testifying before the Ways and Means Committee on February 19, said:

"We are particularly concerned about those metropolitan areas because that is where we once had a tremendous traffic since repeal, as a matter of fact, clear up to 1939. There you have a more or less gallon-per-gallon displacement of tax-paid spirits. We are tremendously concerned about that problem. We are tremendously concerned that we do not re-create that problem."

Since that time there has been a continuation of large still seizures in metropolitan areas.

On April 8 a 325-gallon still was found in Westbury, Long Island. In Maryland, a 400-gallon still was seized near Baltimore on May 19. A 300-gallon still was seized in Mount Vernon, N. Y., on May 24. About 2 weeks ago, a 2,500-gallon still was seized, operating in a camouflaged chicken house in suburban New York. Agents said the still had been operating for several months. Neighbors said they had been smelling what they thought was wine for home use since last summer. The operation used seven vats, each 8 feet wide and 14 feet deep.

Large-scale metropolitan area bootlegging is carried on by highly organized, well-financed criminal groups. Chairman John F. O'Connell, New York State Liquor Authority, last week told the Chiefs of Police of New York State: "The facts available indicate that larger stills are being set up nearer to large urban centers of population."

In June representatives of eight mid-Atlantic States (New York, New Jersey, Massachusetts, Rhode Island, Delaware, Connecticut, Maryland, and Pennsylvania), and the city of Baltimore, met to discuss the great increase in bootlegging in the metropolitan and industrial areas of those States.

Following the meeting, Chairman Stayer, of Delaware, issued a statement in which he said that members of the committee "expressed concern over indications that racketeers and criminal syndicates may be entering into the manufacture and sale of illegally produced, non-tax-paid alcohol and distilled spirits."

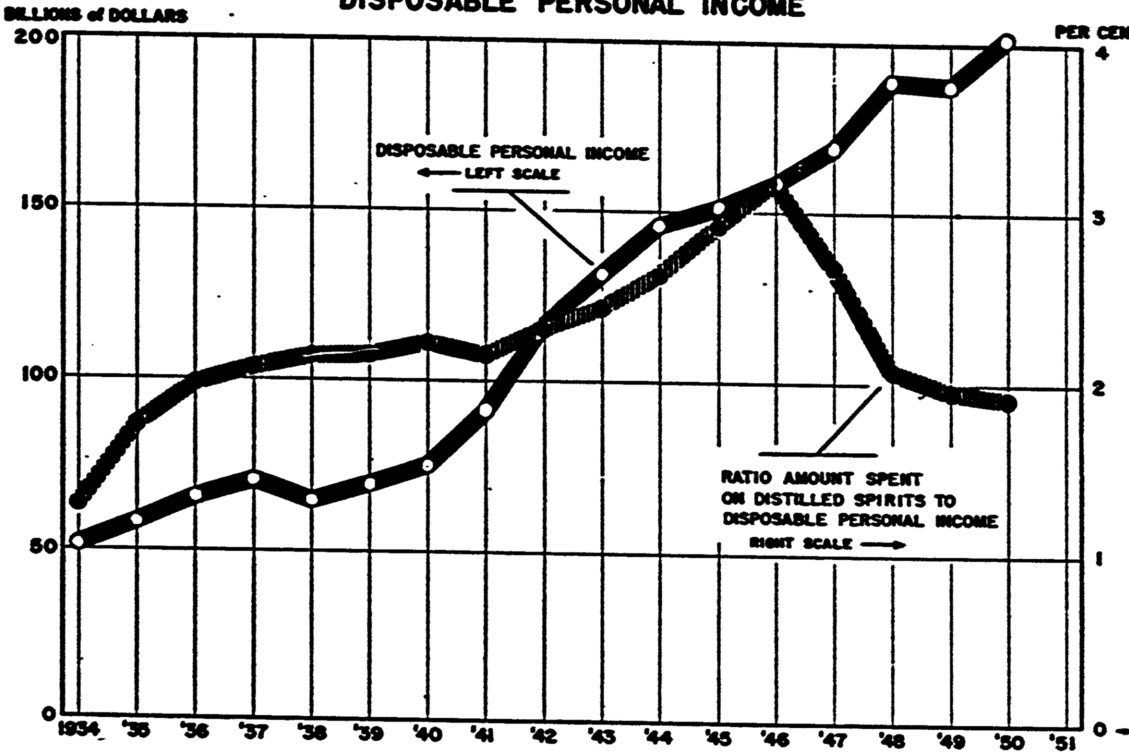
The Ways and Means Committee report recognizes that a tax increase will furnish increased financial incentive for illicit operations, but indicates that this is likely "to be more than offset by tightening of the labor supply available for these operations and by higher incomes on the part of consumers which will decrease the importance of the price differential between tax-paid and non-tax-paid liquor."

We cannot agree with this analysis, having in mind the increasing amount of bootlegging created by the existing tax differential of $11.57 a gallon.

We cannot determine how many persons are engaged in the illegal traffic. But we believe it strains the imagination to assume that an improved labor market will, as the House report suggests, create a manpower shortage for the bootlegger when it is considered that the bootleggers' enormous profits justify paying wage scales—not subject to wage stabilization—in excess of any which any legal industry could pay.

The answer to the bootleg problem lies in increased funds for enforcement. It also lies in a saner level of excise taxation. And the combination of better enforcement and sensible rates will in the long run produce maximum revenues for the Federal Government and for the States.

RATIO OF DISTILLED SPIRITS EXPENDITURES TO DISPOSABLE PERSONAL INCOME



(The following information was later supplied for the record:)

America's Biggest Tax Leak Getting Bigger—A Special Study

(Prepared by Licensed Beverage Industries, Inc., New York, N. Y.)

FOREWORD

This is the second edition of a special survey of illegal distilling in the United States, made by Licensed Beverage Industries, Inc. It is based on facts and figures furnished by Federal, State, and local government enforcement officials.

LBI wishes to express its deep appreciation for the help received from ATU investigators, State enforcement officials, local sheriffs and police.

The individual questionnaires and other factual material from which the illegal distilling figures in this survey were compiled are available for inspection at LBI's offices.

ONE QUIZZ QUESTION YOU CAN'T ANSWER

Question. Which American industry has the largest number of manufacturing enterprises? Automobile manufacturers? Steel companies? Airplane manufacturers? Electric appliance makers?

Answer. Unfortunately, it is illegal distilling—a business operated outside the law.

In 1950, according to Federal, State, and local government seizure figures, 10,644 illegal stills were picked up.[1] Even assuming that this figure represented all the stills in existence—and it certainly didn't—it means that the number of illegal stills in operation in that year was larger than the total units for any other manufacturing industry in the country. The 10,644 illegal stills seized is a larger total than the total units in the saw mill industry, which had the largest number of components of any American manufacturing group, according to the Bureau of Census—10,223 units. Commercial printing, with 11,032 businesses ranked next. The bottled soft drinks, women's dress and metal working machinery industries had an aggregate total of only 14,280 manufacturing enterprises.

(By the way, the number of legally licensed producers of tax-paid distilled spirits were 240, according to the Bureau of Census, including 127 licensed distillers of whisky and 119 fruit distillers producing rum and brandy. There were more than 80 times as many illegal distillers in 1950.)

Illegal distilling is a little bit out of place because, of course, it is a criminal industry operating outside the law. What makes it doubly unfortunate is that it happens to be one which contains more energetic manufacturers than any other American industry—every one of them is a criminal who belongs in jail. Every one of them is cheating governments out of untold sums of tax money every year.

And that brings up another point.

The business is dangerous; enforcement agents search the operators out unceasingly. But illegal stills keep going back into business—more of them every year. Therefore, it must follow that there is a tremendous profit incentive in this criminal operation. No crook is going to set up a business if he doesn't feel pretty certain that he is going to get more than his investment back.

Since 1946 (the end of World War II) there has been a sharp upward spiral in the number of illegal stills seized.

In those 5 years the average size of the individual stills has been increasing.

Since 1946, illegal distilling has been spreading increasingly into the States north of the Potomac—in and around large metropolitan areas.

Illegal distilling is no longer a hillbilly, amateur operation.

High taxes on legal liquor put the price out of the reach of many average Americans. This is one of the major reasons for setting up this operation in a big way—because it is one of the most profitable criminal operations in the country today.

Let's look at the facts.

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[1] In this study, State and local figures are reported on a calendar-year basis and Federal figures on a fiscal-year basis. 1950 calendar figures of the Federal ATU are not yet broken down by State. Hence the necessity for employing fiscal-year figures on Federal ATU seizures. The difference is slight—10,030 for the fiscal year against 10,200 Federal seizures in the calendar year.

ILLEGAL STILL SEIZURES ARE GOING UP

In 1950, a grand total of 19,644 known illegal stills were seized by Federal, State, and local enforcement officials.

In 1949, the first time in which a Nation-wide survey was conducted by LBI, the known illegal still seizure total was 18,884.

In the past 2 years, in other words, enforcement agents in this country have been picking up illegal stills at the rate of better than 53 a day. They have uncovered nearly 40,000 criminal manufacturing enterprises engaged in the illegal production of liquor.

These figures are conservative—for two reasons:

First, the total number cannot be determined because there is no official census of illegal distilleries. We can go only by the stills actually seized by enforcement agents.

Second, the figures in this survey are incomplete because in many States the local authorities who share substantially in the task of enforcement, do not report their activities to any central agency.

LBI does not have total Federal, State, and local figures for any year prior to 1949. But the Federal figures which do go back are meaningful. Seizures of illegal stills by Federal agents alone have skyrocketed 58 percent since 1946, from more than 6,000 to more than 10,000 in five brief years.

(Refer to table I in appendix.)

DID YOU SAY 20,000?

That's what we said.

During 1950, the LBI survey reveals, Federal agents seized 10,030 illegal stills. (See note of page 8.) State and local authorities seized a minimum of 9,614 illegal stills. Those two totals represent those seizures made independently—the Federal total, in other words, includes no seizures reported by State and local authorities and the State and local total includes no seizures reported by Federal authorities.

Those two figures add up to the alarming sum of 19,644 illegal stills seized during 1950.

This total does not, as we mentioned previously, even purport to be all-inclusive. Only five States were surveyed on a county-by-county basis: North Carolina, South Carolina, Tennessee, Mississippi, and Oklahoma.

In none of those States did all the counties return the survey questionnaire.

The explanatory text that accompanies table II explains in detail our reason for thinking the 1950 figure of 19,644 is conservative. After you have read it, we think you will agree.

(Table II in the appendix gives the individual State-by-State figures.)

OUTPUT CAPACITY GROWING FASTER THAN NUMBER OF UNITS

Number is one thing but size is still another.

The number of stills seized each year since the end of World War II has been zooming. The producing capacity of the stills has been climbing even faster.

Take the Federal figures alone (on the average, about half the still seizure total). Since 1946 the number of illegal stills seized by Federal agents has gone up 58 percent. During that same calendar period, the daily producing capacity of those illegal stills has gone up 80 percent. During the first 9 months of the fiscal year ending June 30, 1951, the daily producing capacity of the illegal stills seized (again, by Federal agents only) went up almost 16 percent over the same months of the fiscal year 1950; during that same time the number of stills seized went up 2.2 percent.

The expression "daily producing capacity" means just that. Federal agents always try to make a check, when they seize an illegal still, of how many gallons of illegal liquor that particular still is capable of producing on a daily basis. Many State and local authorities do the same thing. Hence, we can get some idea of how much illegal, tax-dodging liquor criminal operators are equipped to turn out on a daily basis. This amounts to 677,170 proof gallons. (LBI makes no claim that all these stills operate every day.)

That capacity figure is 109,103 gallons larger than the total amount of legal, tax-paid whisky actually produced daily by the legally licensed distillers during 1950.

THE STILLS ARE GETTING BIGGER ALL THE TIME

The fact that capacity is growing at a faster rate than the number of illegal stills actually seized means only one thing: That the average individual still is getting bigger.

This means that the illegal distilling industry is digging in, consolidating into higher-capacity units which make possible the mass production of illegal liquor for large markets.

Another significant measure of this trend is found in the value of property (chiefly stills, automobiles, and trucks) reported as seized by Federal agents alone. The value of such property seized during the first 9 months of fiscal 1951 was 24 percent above the value of property seized during the same period of fiscal 1950 (and 35.8 percent above the value of property seized in 1939–40 when a fair number of illegal distilling syndicates were still operating in this country).

The average still seized last year had a daily producing capacity of about 34 gallons. The State average actually ranged from a low of about 10 to a high of about 277 gallons. The Federal average, for the country as a whole, was 30 gallons; the year before it was 28 gallons, and the year before that 27 gallons. In almost all instances, however, where individual State and county figures were available, the State and county averages were higher than the Federal average.

Many of the stills seized north of the Potomac run in the neighborhood of 500–1,500 gallons daily capacity, and there have been press reports of some as high as 3,000-gallon capacity.

In arriving at total producing capacity, LBI used State and local figures where they were available. But they were available in only seven instances, so that in all others LBI used the Federal average for the Federal supervisory district in which the State was located.

This, then, is another instance of where the capacity total of more than 677,000 gallons per day is underestimated. There is no question but that if it had been possible to secure capacity figures for each still seized by State or local agents, the United States total would have been dramatically higher.

(A detailed explanation of the capacity figures will be found in exhibit II in the appendix. It is well worth reading.)

LOT OF ILLEGAL LIQUOR—LOT OF LOST TAXES

Now, 677,179 gallons per day is a lot of illegal liquor. That is also a lot of lost revenue for Federal, State, and local governments. Every single day that all of the 19,644 seized illegal stills operated at capacity, Federal and State Governments were cheated of more than $7 million in excise taxes alone.

At the present time the Federal Government's excise tax on legally produced spirits is $9; the average State government has an excise tax of $1.48.[1] The combined excise-tax rate alone thus averages $10.48. And that is how much is lost in excise taxes by Federal and State Governments each time a gallon of illegal liquor is produced. Multiply that by the daily producing capacity of 677,170 proof gallons and you get $7,096,836 in lost excise revenue for each day that all of these illegal stills operated at capacity.

Once again LBI makes no claims that all these stills operate daily. It does claim, however, that the tax loss is tremendous.

Naturally, no one actually knows how much illegal liquor is produced and consumed, but with 19,644 stills being seized annually it must be a lot. The alcohol tax unit in Pennsylvania was quoted as saying that illegal operators in the city of Philadelphia were doing a business of $125,000 a day—or over $40,000,000 a year.[2]

Vance Packard, writing in the September 1950 issue of the American magazine, estimated that just one North Carolina County (Wilkes) was producing 500,000 gallons of illegal liquor a year—amounting to $2,000,000 at producer prices.

A release in the Nashville (Tenn.) Tennessean of February 9, 1951, indicates that the 705 stills seized by the State alcohol tax division in collaboration with ATU agents last year, saved the State some $5,248,000 at the daily production rate of 22,877 gallons for these stills.

Sellers of illegal liquor in Alabama are gypping taxpayers of that State out of an estimated $5,000,000 per year, according to a statement given the Mont-

[1] This does not include other State taxes on distilled spirits. Such as sales taxes and license fees.

[2] Source: Philadelphia Inquirer, April 6, 1949.

gomery (Ala.) Advertiser, December 6, 1950, by the head of the Federal Alcohol Tax Unit in Montgomery. At the same time he told this newspaper that the 38 ATU investigators in Alabama were saving the Government at least $1,300,000 in revenue losses each year. These losses, he said, were prevented by seizure of illegal whisky and mash.

WHERE IS ALL THIS GOING ON?

Illegal distilling more and more is becoming a big-time operation, a big-city operation—as well as a big-money operation.

The figures in the appendix of this booklet show that the largest proportion of illegal stills is seized in the States below the Potomac. To assume from those figures, however, that illegal distilling is largely a southern problem is erroneous.

A joint meeting of the liquor administrators for the open-sales States of Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, and the city of Baltimore was held in New York early in June. This group of States (with the exception of a monopoly-sales State, Pennsylvania, which was an invited participant) formed the eastern regional committee of the National Conference of State Liquor Administrators. The chairman, Col. Edgar S. Stayer, of Delaware, in a press statement following the meeting, said that members of the committee "expressed concern over indications that racketeers and criminal syndicates may be entering into the manufacture and sale of illegally produced, non-tax-paid alcohol and distilled spirits." State liquor administrators, according to the release, "agreed that there is need of cooperative steps to arrest the trend toward the illicit liquor traffic in this area (the States in the northeastern region above-named)."

Colonel Stayer expressed the view that "although the suppression of the illicit traffic is primarily the responsibility of the law-enforcement agencies of the several States and the Federal Government, it is the duty of the ABC (alcohol beverage control) agencies to take every reasonable precaution to prevent the illicit traffic from penetrating the legitimate taxpaying alcoholic beverage industry and thus undermining the control systems."

During the last few years an ever-increasing number of illegal-still seizures has been made in northern metropolitan areas—in particular, in the New York-New Jersey-Connecticut-Pennsylvania area.

In point of fact, the number of State and local seizures in the northeastern States has increased by 61.5 percent between 1949 and 1950, while the grand total of Federal and State seizures in these States has gone up by 46 percent.

More importantly, many of the illegal stills found in this area are high-column professional units capable of producing from 500 to 1,500 gallons of 180–190 proof alcohol per day—the equivalent of 900 to 2,800 gallons of illegal liquor when cut for sale.

In brief, these are big-business operations of the size commonly found during prohibition days. Significantly, too, as Mr. Erwin Hock, director of New Jersey's Division of Alcoholic Beverage Control, recently pointed out before the House Ways and Means Committee:

"In some of the arrests that we made in connection with the stills, we have recognized some of our friends, you might say, from early repeal days and even prohibition days, who are going back into business."

Recent press reports further suggest that illegal stills in the upper tier of Southern States are beginning to market their products not only in States farther south, but to some degree in urban centers to the north. Seizures of illegal liquor produced in Virginia and North Carolina have been made in Washington, D. C., and in Maryland cities. In turn, New Jersey operators were recently arrested at their stills in Maryland.

PROFITS OFFSET THE RISK FACTORS

Only the stupidest type of illegal operator would embark on a career if he knew that he was almost certainly going to be picked up before financial returns made it thoroughly worth while.

In the Northeastern States, illegal stills representing an investment of from $20,000 to $50,000 have been seized with increasing frequency during the past year—a sharp contrast to the crude equipment of old-fashioned backwoods stills which can be set up at a cost of a few hundred dollars.

Examine the montage of clippings on pages 16 and 17 and notice two significant things: First, that most of them give every evidence of being "big time" operations; the second, that most of them are in areas outside the "deep South."

You will notice, too, that even in the traditional stronghold of "moonshining" in the South, the stills are getting bigger all the time. In the States south of the Potomac, an increasing number of modern "submarine" stills, representing investments of $2,000 to $10,000 are being seized.

Not even a complete fool is going to risk up to $50,000 in any sort of proposition unless the chances are better than even that he is going to come out well ahead of the game. How many days of operation are required for the average still before the investment is realized and before the illegal profits start mounting up? Nobody really knows.

Obviously, the incentive is tremendous.

THE INCENTIVE? PROFITS!

The illegal distiller has a definite business objective: Profits. Unlike legitimate business, however, his profits are magnified by the fact that he pays no taxes. And it is the continued excessive level of taxes on legal liquor in the postwar period—taxes amounting to 10 times the cost of production—which have prompted the illegal distiller to make a come-back.

How did this come about?

As we all know, some small amount of illegal distilling has been carried on in the mountain regions of the East since Colonial times. In most cases, however, this activity has had little or no significance; most illegal liquor was produced for home or "neighborhood" consumption.

On at least three previous occasions in United States history, however, illegal distilling activity precipitated by injudicious tax policies reached proportions which resulted in a complete breakdown of Federal, State, and local regulations surrounding the manufacture and sale of legal liquor.

The first of these occasions was the ill-fated effort of the Federal Government to impose increasing amounts of tax on the manufacture of spirits from 1791 to 1801 (the Whisky Rebellion), which culminated in the repeal of the tax.

The second instance occurred in the Civil War, when distilled spirits taxes of $0.60 per gallon imposed in 1864 were raised successively to $1.50 later in the same year and to $2 per gallon in January 1865—bringing the tax between 8 and 12 times the production cost of $0.17 to $0.25 per gallon.

Federal revenue collections from distilled spirits at the $2 rate for the period 1865-68 fell off by over 20 percent from collections at the $0.60 tax level of 1864—despite the great increase in the rate itself. Only when Congress reduced the tax rate at the close of the year 1868, to $0.50 per gallon—with an eye solely to reducing the tax-free advantage of the illegal producer—did illegal distilling diminish and revenue returns rise.

In the first fiscal year of the new $0.50 per gallon tax, revenues rose by $20 million over those for 1868 at the $2 tax.

The adoption of the eighteenth (prohibition) amendment in 1919 resulted in the third wave of country-wide illegal distilling. Large-scale, syndicate-type illegal distilling got under way within a year to fill the unprecedented vacuum between supplies and the actual existing consumer demand for spirituous liquors. The racketeers of the prohibition era succeeded in producing and distributing an all-time record output of so-called whisky averaging around 170,000,000 gallons annually, according to the Warburton report. As a result, Government agents at the prohibition peak were seizing around 25,000 stills annually in an effort to enforce an unenforceable law.

These illegal operations continued well after the repeal amendment was passed in 1933. In the first place, although the repeal amendment was ratified by the necessary 36 States by the close of 1933, it was not until 1936 that all but three States actually set up the machinery for legal sale within their borders. Moreover, the legal industry, which had been in enforced idleness for 13 years, required about 5 years in which to build up stocks of properly aged whisky to meet consumer demand.

These factors left the racketeers of the prohibition era a substantial, if steadily declining, market for illegal liquor until the very late thirties.

Public groups and legislators of the early repeal period were determined to keep taxes on legal spirits at reasonable levels so that the newly reinstated legal industry would be able to compete with the well-entrenched illegal industry.

The joint report of the House Ways and Means Committee and the Senate Finance Committee in 1933 stated that price competition must be facilitated by "keeping the tax burden on liquor comparatively low to permit the legal industry to offer more severe competition to the illegal competitor."

A study group sponsored by John D. Rockefeller warned in a report entitled "Toward Liquor Control," by Raymond D. Fosdick and Albert L. Scott:

"The temptation to load on to the liquor trade all our governmental deficits should be resisted at all costs, for high taxes will produce high prices and will thus make inevitable the continuance of the moonshiner, the bootlegger, and the whole system of corruption."

Thus prior to World War II, Federal excise rates on distilled spirits had been increased with much caution, rising gradually from $1.10 per gallon at repeal to $3 per gallon by 1940 and to $4 a gallon in 1941.

Then, in 1942, the Federal Government increased the excise rate to $6 per gallon. In 1944, a second emergency wartime tax (still in effect) imposed a rate of $9 per gallon bringing the Federal excise tax alone up to over eight times the cost of production.

Moreover, between 1941 and 1950, the burden of all State and local taxes (including excise taxes, sales taxes, license fees, and other levies) on distilled spirits continued to rise.

The total Federal, State, and local tax burden (excise and all other liquor taxes) had gone up in this period from $5.98 to $11.72, a 96 percent increase—10 times the cost of production.

Prices of legal whisky have risen accordingly reflecting only these increased taxes. At the present time, a $3.75 bottle of blended whisky selling in the average States carries a combined Federal, State, and local tax burden of $2.10, more than half the total selling price.

All these factors have occasioned America's fourth major wave of illegal distilling activity.

ALL THIS ADDS UP TO

Increasing illegal distilling means that Federal, State, and local governments are being defrauded of vast amounts of tax revenue.

It means that the average taxpayer is being forced to foot the bill for taxes which the non-tax-paying producer and consumer are avoiding.

And, even more important, it means that liquor law enforcement in scores of communities is breaking down, and that a host of social problems which characterized the prohibition era are again in our midst.

Indicative of the revenues being lost, Federal excise receipts from distilled spirits taxes declined by 25.8 percent between 1946 and 1949 as illegal distilling surged upwards. How much of this loss in legal tax-paid consumption occurred because of divergence of consumer demand to illegal spirits can never be proven; the fact remains that this decline in legal sales occurred despite the maintenance of record levels of personal disposable income in this country (increase of 104 percent over 1941), and despite the fact that the number of persons of legal drinking age increased by 11.7 percent during this period.

At the end of 1950, despite a mild increase in purchases of legal spirits following the Korean War, actual consumer buying of legal distilled spirits was still 22 percent below 1946 levels, although disposable consumer income was 32 percent above 1946 levels, and the number of persons of legal drinking age was 7 percent above 1946.

Thus for the fourth time in United States history, consumer resistance to national policy affecting distilled spirits is creating a multitude of problems which affect us all.

The dangers and evils inherent in a thriving illegal distilling industry are by no means limited to the ability of these criminals to dodge their responsibilites as tax-paying citizens.

Illegal liquor operators, like any other criminals, operate with a complete lack of responsibility to the customer, to society, or to government.

Much illegal liquor is produced under the world's most insanitary conditions. As will be noted from the clippings on page 26 (opposite), illegal still-mash odors have been camouflaged by dog kennels, chicken yards, rotting meat and other devices. Hogs, rats, and vermin have been found buried in vats of mash. Runs of liquor may be made through rusty pipes.

Bottling is frequently done with utter disregard for sterilization of used bottles which may have passed through dump yards, garbage cans, and so forth.

By-the-drink sales in abandoned shacks, gasoline stations, disreputable pool halls and other locales are made without regard to any sanitation standards. Illegal retailers have been known to dilute illegal liquor with shellac thinner and other poisonous denatured alcohol products.

Thus illegal operators knowingly risk both life and limb even of their customers. Operating out of the bounds of the tight and strictly enforced regulations which insure the sanitary, safe, and orderly production and distribution of legal spirits, they know no restraints as to the quality of raw materials used in their product, as to sanitation, maintenance of an orderly place of business, or as to restrictions on sale to minors or unfit persons.

These are a few of the conditions which the illegal distilling industry is creating in our communities. Will it be allowed to spread?

APPENDIX

TABLE I.—*Number and daily producing capacity of illegal stills seized by Federal Alcohol Tax Unit investigators (exclusive of State and local government seizures), fiscal and calendar years 1946–50, inclusive*

Year	Federal illegal still seizures		Daily producing capacity	
	Fiscal years	Calendar years	Fiscal years	Calendar years
			Gallons	*Gallons*
1946	6,041		172,420	
1946		6,461		164,470
1947	6,053		149,964	
1947		6,028		150,914
1948	6,757		173,087	
1948		7,551		200,811
1949	8,006		224,858	
1949		8,551		240,450
1950	10,030		287,800	
1950		10,206		307,782

NOTE.—These data relate only to seizures made by the Federal Alcohol Tax Unit. They do not include seizures made by State and local authorities.

Source: Prepared by Licensed Beverage Industries, Inc., from data of the Alcohol Tax Unit, Bureau of Internal Revenue, Treasury Department.

EXHIBIT I. NOTES ON ILLEGAL STILL SEIZURES MADE IN 1950

These figures consist of Federal still seizures for the fiscal year 1950—the only annual period in which State-by-State totals were released—and of calendar year 1950 seizures reported by State and local governments. It should be noted that the resulting total is highly conservative, since total United States Federal seizures for the calendar year were in fact somewhat higher than those for the fiscal year.

It should also be pointed out that Federal seizure totals cover all raids made by Federal authorities plus all seizures made with the assistance of State or local authorities.

State seizure totals include only those seizures made independently of the Federal Alcohol Tax Unit. Local seizure data, where collected, includes only those seizures made by local authorities independently of either State or Federal authorities.

The actual total of illegal still seizures made by county officials in North Carolina is undoubtedly much higher than the total of 1,772 stills, reported here. The true 1950 total is estimated at a minimum of between 2,600 and 3,500 units, which in turn would increase the grand total of known Federal, State, and local seizures to between 20,410 and 21,300 units, rather than the 19,644 reported by Licensed Beverage Institute.

The 1949 still seizure total reported to Licensed Beverage Institute by the North Carolina ABC Board from its survey of local enforcement officials (who are solely responsible for enforcement in such cases in North Carolina) was 5,496 units. ABC officials estimated last year that about 10 percent of these cases had been made with the assistance of Federal agents and were therefore reported in Federal totals. Accordingly, Licensed Beverage Institute reported the North Carolina total last year as 4,946 units seized independently of Federal officials.

Subsequent detailed evaluation of the data obtained from the Board last year indicate that this total, with minor exceptions, was substantially correct.

This year, because the State ABC Board was unable to undertake a second study, Licensed Beverage Institute made its own survey of seizures made by county officials independently of the Federal Alcohol Tax Unit.

Replies were received from only 76 out of 100 countries, in contrast to 87 counties reporting to the ABC Board last year. Moreover, in 11 of the 76 counties reporting, local sheriffs who had taken office as of December 1, 1950 were unable to obtain records of activities of the previous sheriffs. Thus a total of 85 counties did not report, or could not report still seizure totals. Many of these counties had still seizure totals of 100 or more units last year.

If the number of stills seized in these 85 countries is estimated at the average number of seizures for those counties reporting in 1950, an additional 816 units should be included in 1950 figures, making a total of 2,588 seizures. This was the procedure used by the Board last year in estimating seizures for the 18 counties not reporting.

If, in turn, the 1949 seizure totals reported by 22 of these 85 counties are used as the basis for estimating their seizures for 1950, an additional 1,722 units would have been included, making a grand total of 3,494 units.

Press-clipping data and information gleaned from other sources indicate that even this estimate is probably conservative.

TABLE 11.—*Illegal stills seized in 1950 by Federal, State, and local authorities*

	State and local	Federal	Total Federal, State and local
Alabama	2,028	1,561	3,589
Arizona	0	7	7
Arkansas	25	110	135
California	2	15	17
Colorado	0	1	1
Connecticut	0	6	6
Delaware	2	0	2
District of Columbia	0	1	1
Florida	607	317	924
Georgia	1,962	1,964	3,926
Idaho	0	0	0
Illinois	0	10	10
Indiana	0	13	13
Iowa	0	0	0
Kansas	0	3	3
Kentucky	143	568	711
Louisiana	0	13	13
Maine	0	0	0
Maryland	0	77	77
Massachusetts	0	5	5
Michigan	0	7	7
Minnesota	1	8	9
Mississippi	[1] 107	549	656
Missouri	0	9	9
Montana	0	0	0
Nebraska	0	2	2
Nevada	0	0	0
New Hampshire	0	0	0
New Jersey	36	31	67
New Mexico	0	1	1
New York	0	43	43
North Carolina	[1] 1,772	1,220	2,992
North Dakota	0	0	0
Ohio	0	34	34
Oklahoma	[1] 15	219	234
Oregon	2	7	9
Pennsylvania	25	119	144
Rhode Island	0	1	1
South Carolina	[2] 1,805	1,111	2,916
South Dakota	0	0	0
Tennessee	[3] 522	1,100	1,622
Texas	0	81	81
Utah	0	1	1
Vermont	0	0	0
Virginia	510	690	1,200
Washington	0	4	4
West Virginia	40	110	150
Wisconsin	0	2	2
Wyoming	0	1	1
Grand total	9,614	10,030	19,644

[1] Local seizures only. North Carolina, Mississippi, Oklahoma, have no central State enforcement program.

[2] Including both State seizures made independently of the ATU and local seizures made independently of either the ATU or of State officials.

[3] The Tennessee figures shown are seizures by county officials. State ABC seizures are made jointly with the ATU.

NOTE.—Seizures made by Federal authorities with the assistance of State or local officials are reported in the Federal total only.

Source: Prepared by Licensed Beverage Industries, Inc., from data of the Federal Alcohol Tax Unit and from data of State and local authorities.

EXHIBIT II. NOTES ON DAILY PRODUCING CAPACITY OF ILLEGAL STILLS

At a conservative estimate, the aggregate daily producing capacity of the known illegal distilling industry in 1950 was 677,179 proof gallons per day.

This figure is 199,193 gallons more than the average of 477,986 gallons of whisky which were produced by the legal industry each day last year; it is 249,650 gallons more than the daily average of 427,529 gallons of aged whisky which the legal industry bottled for sale last year.

In arriving at this estimate, it should be noted that the figures shown include 287,869 gallons estimated by the Federal Government as the daily producing capacity of the 10,030 stills which its agents seized in fiscal 1950 (in calendar 1950 the aggregate capacity of stills seized by Federal agents was even greater, 307,782 gallons to be precise).

It also includes 209,798 gallons as the capacity of stills seized by State authorities, independently of the Federal Alcohol Tax Unit during calendar 1950. This figure was arrived at by multiplying the average daily producing capacity for all stills seized, as reported by State authorities, by the number of stills seized, wherever such figures are available. Where average capacity for State seizures were not available, capacity has been estimated at the average capacity for the Federal ATU supervisory district in which the particular States were located.

Additionally, the figure includes 179,512 gallons as the capacity of stills seized by local authorities independently of either the Federal Alcohol Tax Unit or of State enforcement authorities. In the case of Mississippi and Oklahoma, data from the individual localities was so scattered that the average capacity for the tenth and eleventh ATU supervisory districts in which these States are located was used in computing capacity of local seizures.

In the case of South Carolina, an average reported capacity of 50 gallons per day obtained from county authorities and verified as reasonable by State authorities was used in the computation. In the case of Tennessee and North Carolina, figures representing (1) the average capacity of 33.4 gallons for stills taken by Federal and State authorities together in calendar year 1950 and (2) the average for the ATU supervisory district were used.

However, the still capacities reported by local officials in both Tennessee and North Carolina are substantially higher than the figures used. Data considered reliable from Tennessee counties indicated an average capacity of 62 gallons; data from North Carolina counties suggested an average capacity of 68 gallons.

Similarly the 100-gallon per still average shown by South Carolina for its seizures, and the 50-gallon average shown up on county seizures is much higher than the Federal 20-gallon average for the supervisory district in which South Carolina is located.

Data obtained from State sources in the Northern States also indicate a substantially higher average per still than that shown by Federal authorities.

Occasionally, the ATU is unable to make an investigation and report on the exact capacity of a seized still. This is particularly true where fire, explosion, or other circumstances have resulted in the detection of a still—as has happened on several occasions in the last year, especially in the North. Where accurate measurements cannot be made, the ATU does not report a producing capacity even though the still enters into the Federal total. Thus it is not too surprising to find that still seizures minus capacities are reported by the ATU in quite a number of areas. This means, however, that the average producing capacity per still is bound to be indicated as lower than it should because the produdcing capacity of part of all stills seized is divided by all seizures to obtain an average.

TABLE III.—*Average daily producing capacity for illegal still seized by Federal, State, and local authorities, 1950*

[Unless otherwise indicated, capacities are those reported by the Federal Alcohol Tax Unit in the supervisory districts in which these States are located]

	Daily producing capacity of average still seized by ATU, fiscal 1950	Daily producing capacity of average still seized by State authorities, calendar 1950	Daily producing capacity of average still seized by local authorities, calendar 1950
Alabama	26.7	27.5	(1)
Arkansas	13.4	14.7	(1)
Florida	26.7	27.5	(1)
Georgia	26.7	27.5	(1)
Kentucky	20.0	19.1	(1)
Maryland	43.7	(2)	(1)
Massachusetts	71.3	(2)	(1)
Mississippi	13.3	(2)	14.7
New Jersey	155.3	276.5	(1)
New York	64.2	(2)	(1)
North Carolina	43.7	(2)	50.0
Oklahoma	13.3	(2)	14.7
Pennsylvania	63.0	[3] 81.0	(1)
South Carolina	26.7	[3] 100.0	[4] 50.0
Tennessee	20.0	[5] 33.4	[5] 33.4
Texas	13.3	(2)	(1)
Virginia	[illegible]	[3] 60.0	(1)
West Virginia	43.7	[3] 10.0	(1)

[1] No local seizure data obtained by LBI.
[2] No seizures reported by State authorities indpendently of Federal ATU.
[3] Figures supplied by State enforcement authorities.
[4] Average capacity per still as reported by local authorities and as substantiated by comments of State authorities.
[5] Federal average for those seizures made jointly in Tennessee by Federal and State authorities.

Source: Prepared by Licensed Beverage Industries, Inc., from data of the Federal Alcohol Tax Unit, State Enforcement Divisions, and local sheriffs.

TABLE IV.—*Total daily producing capacity of illegal stills seized in 18 major illegal distilling States*

	Number of Federal seizures, fiscal 1950	Number of seizures made by State authorities independent of ATU calendar 1950	Number of seizures made by local authorities independent of ATU or State agents, calendar 1950	Grand total all reported seizures	Total daily producing capacity of stills seized by Federal authorities (proof gallon)	Total daily producing capacity of stills seized by State authorities (proof gallon)	Total daily producing capacity of stills seized by local authorities (proof gallon)	Grand total producing capacity all reported seizures (proof gallon)
Alabama	1,561	2,028	(1)	3,589	41,679	55,770		97,449
Arkansas	110	25	(1)	135	1,474	367		1,841
Florida	317	607	(1)	924	8,464	16,693		25,157
Georgia	1,964	1,982	(1)	3,926	52,439	53,965		108,394
Kentucky	568	143	(1)	711	11,360	2,731		14,091
Maryland	77	0	(1)	77	3,365	0		3,365
Massachusetts	5	0	(1)	5	357	0		357
Mississippi	549	0	107	656	7,302	0	1,573	8,875
New Jersey	31	36	(1)	67	4,814	9,954		14,768
New York	43	0	(1)	43	2,761	0		2,761
North Carolina	1,220	0	1,772	2,992	53,314	0	88,600	141,914
Oklahoma	219	0	15	234	2,913	0	221	3,134
Pennsylvania	119	25	(1)	144	7,497	2,025		9,522
South Carolina	1,111	372	1,433	2,916	29,664	37,200	71,650	138,514
Tennessee	1,109	0	523	1,632	22,190	0	17,458	39,648
Texas	81	0	(1)	81	1,077	0		1,077
Virginia	690	510	(1)	1,200	30,133	30,600		60,733
West Virginia	110	49	(1)	159	4,807	490		5,297
18 States total	9,884	5,757	3,850	19,491	285,620	209,785	179,512	674,917
All other States	146	7		153	2,249	13		2,262
Grand total	10,030	5,764	3,850	19,644	287,869	209,798	179,512	677,179

1 No data.

Source: Prepared by Licensed Beverage Industries, Inc., from data of the Federal Alcohol Tax Unit, and from reports of State and local authorities.

EXHIBIT III.—*Here are the figures on some typical big illegal stills—Total of 30 stills listed below had an average daily producing capacity of 20,409 gallons—or 680 gallons per still—compared with the over-all U. S. Government average of 30 gallons*

Location	Size of reported still (daily producing capacity in proof gallons)	Seized by	Date	Source
Aiken County, S. C.	1,440	ATU and State and local agents.	Mar. 23, 1951	Augusta, Ga., Herald.
Aliquippa, Pa.	1,050	State ABC agents and local police.	Oct. 20, 1950	Liverpool, Ohio, Review.
Babylon, Long Island, N. Y.	[1] 900	ATU	Jan. 30, 1951	New York World-Telegram and Sun.
Boston, Mass. (Norfolk)	350	ATU and local police	Feb. 16, 1951	Boston Post.
Bronx, N. Y.	900	do	Apr. 12, 1951	New York News.
Bullock Creek, S. C.	300	County sheriff	Jan. 19, 1951	Rock Hill, S. C., Herald.
Cabarrus, N. C.	375	ATU	Apr. 12, 1951	Kannapolis, N. C., Press.
Claussen, S. C.	300	County sheriff	Jan. 31, 1951	Florence, S. C., News.
Clayton County, Ga.	500	do	June 5, 1951	Atlanta Journal.
Crawford County, Ga.	844	ATU and State agents	Mar. 29, 1951	Macon Telegraph.
Crestwood, Ky.	300	ATU	Mar. 4, 1951	Louisville Courier Journal.
Dorothy, N. J.	300	State ABC agents and State police.	Jan. 23, 1951	Atlantic City Union.
Downington, Pa. (metropolitan Philadelphia area).	300	ATU	Aug. 26, 1951	Philadelphia Inquirer.
Dublin, Pa.	800	State ABC agents and State police.	July 31, 1950	Easton, Pa. Express.
Florence, S. C.	450	County sheriff	Jan. 29, 1951	Florence, S. C., News.
Freehold Township, N. J. (Asbury Park).	600	ATU and State troopers.	Mar. 2, 1951	Asbury Park Press.
Haverhill, Mass.	1,500	ATU and local police	Jan. 15, 1951	Haverhill, Mass., Gazette.
Hammonton, N. J.	1,000	State police	Feb. 3, 1951	Atlantic City Press.
Houston County, Ga.	1,000	ATU and State agents	Mar. 2, 1951	Albany, Ga., Herald.
Knox County, Tenn.	500	County officers	Apr. 18, 1951	Knoxville News-Sentinel.
Lawrence, Mass.	1,220	Firemen and ATU	Oct. 24, 1950	Lawrence, Mass., Tribune.
Liberty, N. Y.	700	ATU and State troopers	Jan. 3, 1951	New York Times.
Lincoln County, N. C.	500	ATU, State troopers and local sheriffs.	Feb. 16, 1951	Charlotte, N. C., Observer.
Moundsville, Ala.	500	ATU, State ABC agents, and local sheriffs.	Feb. 27, 1951	Tuscaloosa, Ala., News.
Newtonville, N. J.	500	State ABC agents and troopers.	Mar. 14, 1951	Atlantic City Press.
Somerton, Pa.	1,500	State liquor control board agents and local police.	Oct. 20, 1950	Philadelphia Bulletin.
Somerset County, N. J.	550	ATU	Nov. 8, 1950	Newark Star-Ledger.
Washington township, N. J. (metropolitan New York-New Jersey area).	400	ATU	Dec. 14, 1950	Do.
Wayne County, N. C.	480	ATU and county sheriff.	Mar. 16, 1951	Goldsboro, N. C., News-Argus.
Westbury, Long Island, N. Y.	350	ATU	Apr. 7, 1951	ATU.

[1] 500 at 180 proof.

Senator BYRD. The next witness will be Mr. Feldman.

STATEMENT OF NORMAN FELDMAN, GENERAL MANAGER, FEDERAL WINE & LIQUOR CO.

Mr. FELDMAN. Mr. Chairman and gentlemen, I deeply appreciate the opportunity to appear before this distinguished committee.

My name is Norman Feldman. I am a resident of South Orange, N. J. I operate the Federal Wine & Liquor Co. in Jersey City, N. J., dealers in wholesale wine and liquor. I appear here today as a wholesale liquor dealer and also as chairman of the board of the Wine and Spirits Wholesalers of America, a national trade association.

The approximately 470 members of WSWA represent a large majority of the substantial wholesale liquor firms doing business in the 29 free-enterprise States and the District of Columbia.

We wholesalers play a vital role in the chain of production, distribution, sales, and tax collection for distilled spirits. What hurts our business also hurts the retailers and, of course, eventually affects the tax revenues of the Federal, State, and local governments.

While I have a personal interest in being heard, I assure you, gentlemen, that I am very conscious of the pressing revenue problem faced by the Congress. I have kept this in mind in analyzing that aspect of the Government's liquor-tax proposal which affects the wholesaler.

It is apparent to anyone that both the House Committee on Ways and Means and the Senate Committee on Finance are deeply concerned to find every reasonable source of additional revenue without unduly hurting the individual citizen, and in particular without hurting American business, which, after all, must operate on a sound basis and at high speed if necessary taxes are to be obtained.

Any increase in the Federal tax rate on distilled spirits is bound to have a depressing influence on sales of this key revenue-raising product. Already growing consumer resistance to high-tax liquor since the end of World War II is apparent. While sales of most other items of merchandise are up, liquor sales have dropped.

In estimating the revenue return under the proposed tax increase, the Government has made an assumption that is very much open to question. It has assumed that Federal tax receipts for the period since July 1950 provide an accurate base from which to project estimates of future consumption. This is erroneous because it covers the early months of the Korean War, when liquor wholesalers and retailers, anticipating shortages, stockpiled. A lot of liquor on which the tax was paid during this period is still in warehouses and storerooms.

Any estimate of future consumption based on the Korean period tax receipts is incorrect because it does not reflect actual sales to consumers. For the most accurate gage available of consumer purchasing we should look at the sales figures of the monopoly States, which reflect the national consumer purchasing pattern. Their figures show that from July 1950, through May 1951—when Federal excise receipts were up 24.7 percent over the previous year—actual monopoly State sales were up only 12.3 percent. Even that moderate percentage gain reflected a substantial amount of stockpiling by consumers and trade buyers such as taverns, restaurants, and hotels.

The present Federal tax of $9 per gallon on legal distilled spirits is the highest in our history and has been pegged at an emergency war rate since 1941. There is ample reason to believe that the imposition of any additional tax would accelerate illegal distilling and push Federal revenues perilously close to or beyond the point of diminishing returns.

Treasury witnesses before the House Ways and Means Committee and your committee have said frankly that the Government anticipates a falling-off in consumer purchasing of legal distilled spirits if the Government proposal for an increased tax is adopted. Treasury spokesmen anticipate a drop of some 6 percent. This estimated decline is an understatement. The decline in fact, would be much sharper. Experience indicates that a decline in consumption of tax-paid liquor is inevitably accompanied by an increase in the sale of tax-evading liquor. State and Federal records show that under the present $9 per gallon tax, illegal distilling has sharply increased in recent years. Illegal still seizures climbed 58 percent from 1946 to 1950.

President Truman's economic report, just submitted to Congress, contains the following reference to the liquor industry under the heading "Recent Trends and Their Significance—The Emergence of a Defense Economy."

I quote from the President's report:

> However, some industries have been operating at less than capacity levels because of the market situation. Large inventories, and in some cases reduced demand, appear to explain recent drops in output in a number of industries, notably textiles, shoes, and liquor.

It would seem to me that no further evidence would be required to show that liquor sales have fallen off than the statement of President Truman himself.

The liquor tax is not an anti-inflation tax. It is a revenue tax. Evidence pointed out to the House Ways and Means Committee by this industry demonstrates that the Federal Government will receive at most only a negligible amount of additional revenue but more probably substantially less revenue as the increased price of legal distilled spirits drives consumer purchasing out of legal liquor channels and into illegal avenues.

The distilled spirits wholesaler today is operating on a profit margin that has diminished dangerously in the past 5 years.

It may come as a surprise to the members of this committee that the retail price of distilled spirits in this country has not increased since 1943 except by the amount of tax which has been imposed by Federal and State Government.

Senator TAFT. What happened to the price?

Mr. FELDMAN. I beg your pardon?

Senator TAFT. Are there figures showing the average price of liquor since the $9 tax was imposed?

Mr. FELDMAN. Since the tax was imposed there has been an increase—in fact, before the $9 tax, in 1943, a year before the present $9 rate became effective, that became effective April 1, 1944, and the industry has not raised its price because we feel that the price today is too high for the product that we offer the American consumer.

The American consumer cannot afford to pay today's price, so we in turn, even though we have had the latitude under that period when OPA came off and the present period when OPS came on, even though during that period there was ample opportunity for wholesalers and retailers to raise their price, we did not raise the price.

Instead we pressed that the Government remember its pledge in giving us that $3 additional in 1944 and reduce the tax by $3.

Senator TAFT. I never understood that to be a pledge. I never made any pledge.

Mr. FELDMAN. The word may be a little too strong, Senator. I was simply referring to the fact——

Senator TAFT. It was imposed as a war tax and never taken off, but I do not remember any pledge.

What occurs to me is that the average income has increased 25 to 30 percent, the average income of families and purchasers, since 1943, and the price of everything else has gone up.

Mr. FELDMAN. That is true, sir. The price of everything else has gone up, as I explained here, 50 percent, but our sales in the distilled-spirits industry have been declining since 1946; whereas other commodities have been going up in sales.

During all this time costs of doing business have mounted steadily—labor, rent, transportation, etc.

The wholesaler has not increased his price to a more realistic level because consumer resistance to liquor prices suggested that any increase would have occasioned an even more pronounced falling-off in sales. During the same period of time, however, the cost-of-living index—based on consumers' retail purchases—has moved up 50 percent.

That is a figure of the Bureau of Labor Statistics.

A tax increase would further discourage consumer purchasing, increase the wholesaler's cost of doing business, and shrink his profit margin even further.

It is important to bear in mind just how prepayment of an excise tax on liquor affects every branch of the industry—distiller, wholesaler, retailer alike. The tax must first be advanced by the distiller before the whisky is withdrawn from bond for bottling. Then in turn it must be prepaid by the wholesaler and then the retailer before the consumer who buys it ultimately pays the tax. An average period of 6 months passes from the time of withdrawing the whisky for bottling until the consumer buys it. Actually, the prepayment of an added $1.50-per-gallon tax would amount to a 10-percent additional capitalization for all wholesalers.

From these facts, Mr. Chairman, it appears that any increase in the tax on distilled spirits would do more harm than good. Any increase in the tax would bring about an increase in bootlegging and all the lawlessness that goes with it. Because of this tax-dodging competition, together with growing consumer resistance, legal sales would fall further and anticipated revenue would not be forthcoming.

Furthermore, the resulting prohibitive price would deny the product to the average citizen. And lastly, great damage would be inflicted on the legal liquor industry.

For these reasons, we hope that the committee will not adopt the proposed increase.

Senator BYRD. Thank you very much, Mr. Feldman.

Senator KERR. Mr. Chairman, at this point I would like to read into the record a part of the statement of Mr. Carroll E. Mealey, Deputy Commissioner, Alcohol Tax Unit, Bureau of Internal Revenue, before the House Ways and Means Committee on Monday, February 19, 1951, as follows:

My own views about liquor excises may be stated very simply. Such taxes will be reflected in increased prices to consumers who with their expanded purchasing power will continue to consume a large volume of liquor. Let me make one point clear—the liquor industry does not pay these taxes, although they do act in some respects as the collecting agency. Liquor price changes following every tax increase are sufficient proof that the consumer, not the producer, pays these taxes.

The total cost of liquors to the American public has been variously estimated. The Department of Commerce has estimated the liquor bill to be in excess of $8 billion a year. I am convinced that with prospective shortages in consumer *goods the American public would pay an additional $700 million if the taxes were increased as proposed, and that the Federal Government could add that much to its tax income.*

Now I understand that there is considerable concern over an anticipated increase in bootlegging as a result of the proposed $12 rate on distilled spirits.

Let us not forget that the Government must have revenue and that the tax yield can be increased by more than $700 million through the suggested rate changes. There is no question but that non-tax-paid liquor competes with tax-paid spirits in the low-income market. Consequently, any substantial increase in liquor taxes increases the law violator's competitive margin and furnishes the violator an additional incentive to defraud the revenue.

The non-tax-paid liquor traffic, like all criminal enterprises which have as their objective the profit motive, is strictly a police problem. Through effective policing and prosecution it can be reduced and controlled and in certain areas virtually eliminated. Just how effective the unit's enforcement effort has been in suppressing the non-tax-paid liquor traffic and in increasing and protecting the revenue is reflected by the fact that gallons of mash seized at illicit distilleries which is the best measure of enforcement progress, decreased from 21,800,000,000 gallons for the fiscal year 1935 to 4,800,000 gallons for the fiscal year 1950, or by 78 percent.

During the same period of time, tax-paid withdrawals of domestic and imported spirits increased from 82,558,000 proof gallons to 157 million proof gallons or by 90 percent.

This result was accomplished despite an increase in the excise rate on distilled spirits from $2 to $9 a proof gallon during the same period of time.

Senator BYRD. Mr. McGinn.

STATEMENT OF EMMETT McGINN, REPRESENTING THE NATIONAL LICENSED BEVERAGE ASSOCIATION

Mr. McGINN. My name is Emmett McGinn, representing the National Licensed Beverage Association.

Mr. Chairman, and gentlemen of the committee, I live in Philadelphia, Pa., where I own and operate a retail establishment selling food and alcoholic beverages for consumption on the premises.

My appearance is on behalf of the National Licensed Beverage Association, a national trade group of owners of restaurants and taverns selling alcoholic beverages. Appended to my statement is a list of the local and State associations affiliated with the National Licensed Beverage Association.

I speak for that segment of the alcoholic beverage industry which composed of the greatest number of individual licensees, each of whom owns and operates his business not as an investment but as a means of livelihood for himself and family. It is my purpose to explain the effect of increased alcoholic beverage excise taxes upon my business and the business of approximately 160,000 licensed retailers who are small-business men like myself.

We are the tax collectors for the Federal Government as regards excise taxes on alcoholic beverages. As such, we are in direct contact with the taxpayers who are our customers, and we are the first to feel the impact of buyer resistance to the taxes. Our margin is small, so we must depend on volume sales for our profit. Any threat to this volume is a threat to our existence.

Today, for every dollar taken in, the average well-run restaurant or tavern pays out 50 cents for food and beverages, 30 cents for wages and 15 cents for such operating costs as rent, repairs, replacement, laundry, insurance, business taxes and advertising. The 5 cents that is left to us we share with the Federal and State Governments in income taxes.

Since 1946, our share of the 5 cents, and the Government's share as well, has been threatened by a decreasing volume of sales. This decline has been recognized by the Federal Government in its regulation of our prices, as we are the only industry which has thus far been given a price yardstick based upon our food and beverage cost per dollar of sales.

I would like to cite two principal causes for this decline: First, it is consumer resistance to high-taxed beverages. Ounce for ounce, alcoholic beverages cost more in an on-premises establishment than in one making sales by the package because of our high labor, equipment overhead cost. The tax-conscious consumer is buying by the bottle for home consumption and he is not buying as much of that legal liquor as he once did. During the war years, restaurants and taverns sold 65 to 70 percent of all distilled spirits, and now we sell only 30 to 35 percent.

The second cause of our decline in sales volume concerns the price advantage which has been given to the illegal product. To most people, illegal manufacture or moonshining connotes a backwoods operation for local consumption. However, to me it means an entirely different matter because these operations are taking customers from the tavern industry in my city and elsewhere. In my official capacity with our association in Philadelphia, I receive requests from members to report speak-easy operations to the police. These requests have become so frequent that I asked our police department about the volume of such operations. During the first 6 months of this year, our police made 532 seizures of illegal liquor.

In 17 of those seizures, no arrests were made because the individuals concerned were not apprehended. But in 515 of the seizures, arrests varying from 1 to 20 persons were made. These all involved illegal retail pouring spots for illegally produced liquor. The newspaper articles one reads about still seizures indicate competition for the distiller, but these seizures I have mentioned constitute a vicious kind of competition for the small retailer who is losing his market because of price competition. The current retail price of moonshine in Philadelphia is now $1 a pint. We know that locally there is always a ready supply. Last year in a single day, a 1,500-gallon still was seized in Philadelphia and a 1,050-gallon still was seized in the outskirts of Pittsburgh. Two weeks ago, a still was seized in the building next to the one in which our local association has its offices.

This situation exists today under the present tax. Any increase in the tax could only result in sending more and more people to the illegal operator, breeding increased disrespect for the law, and bringing about a return of all the social evils of prohibition days.

We ask that the committee, in approaching this excise-tax question, remember that while the 160,000 on-premise retailers are tax collectors, that they are also taxpayers under the Federal income-tax law. This is especially significant when you consider that they also employ thousands of taxpayers. In terms of lower returns from this group, any additional excise tax will cut deeply into Federal revenues.

Along with the other segments of the alcoholic-beverage industry, the on-premise retailers would be hit by increased cost of financing if the excise taxes were raised. We pay the excise taxes in a lump sum through our supplier and reimburse ourselves a penny at a time. The result is that the cost of maintaining inventory will be materially increased if taxes are increased. This is easily seen merely by looking at the situation which will face the small retailer as regards floor-stocks tax.

Senator KERR. Would you explain that statement of reimbursing yourself a penny at a time?

Mr. McGINN. The date the tax becomes effective, the Federal Government requires that all holders of tax-paid alcoholic beverages——

Senator KERR. You mean you pay the tax?

Mr. McGINN. Yes, sir.

Senator KERR. You say you reimburse yourself a penny at a time?

Mr. McGINN. As we sell each drink.

Senator KERR. How much do you get for each drink?

Mr. McGINN. It depends on a number of factors, sir. There are various prices from 25 cents to ——

Senator KERR. What I am curious about is the meaning of the statement that you reimburse yourself a penny at a time.

Mr. McGINN. Well, the increase——

Senator KERR. Does that mean that the tax on a drink is a penny?

Mr. McGINN. The actual cost of the tax as it applies to my tavern in Pennsylvania would be about 47 cents a bottle, sir.

Senator KERR. I am just asking you if the meaning of this is that the tax on one drink is a penny?

Mr. McGINN. No, sir. The word "penny"—by that we mean an insignificant rate of recovery for the large amounts of money that we expend in one lump sum. We have to pay the Government for the total amount of the tax due on the increased—if the increase goes through.

Senator KERR. Then you must get that back from the customer?

Mr. McGINN. As we sell each drink. By "penny" we do not mean that we charge exactly 1 penny per drink.

Senator KERR. How many drinks are there in a quart bottle?

Mr. McGINN. Thirty-two generally, sir.

Senator KERR. Thirty-two. And what is the tax you pay on a quart bottle?

Mr. McGINN. Under this increased tax?

Senator KERR. Now.

Mr. McGINN. Well, it varies by States, sir.

Senator KERR. In your State?

Mr. McGINN. In my State of Pennsylvania? It depends on the proof again. Well, take the average. Take 86——

Senator KERR. The Federal tax is $2.25 per quart.

Mr. McGINN. On a hundred proof.

Senator KERR. What do you average as your selling price?

Mr. McGINN. The majority of what I pour is 86.8.

Senator KERR. Would the tax be less than $2.25 a bottle?

Mr. McGINN. It would be 86.8 of the $2.25.

Senator KERR. Then that would be about $2 a quart, something in that neighborhood?

Mr. McGINN. Yes, sir.

Senator KERR. You get 32 drinks out of a quart?

Mr. McGINN. Yes, sir.

Senator KERR. So that the tax on a drink is about 6 or 7 cents. Seven times 32 would be 224.

Mr. McGINN. Yes, sir; that is right.

Senator KERR. So that it would be between 6 and 7 cents?

Mr. McGINN. Yes, sir.

Senator KERR. What do you average getting for that drink?

Mr. McGINN. Twenty-five and thirty cents.

Senator KERR. Twenty-five or thirty cents?

Mr. McGINN. Yes, sir.

Senator KERR. Now, then, if this were increased $1.50 a gallon, that would be 37.5 cents a quart, or about a penny a drink?

Mr. McGINN. As far as the Federal Government is concerned.

The Pennsylvania State government would then mark it up 48 percent in addition and add on top of that a 10-percent relief tax.

Senator KERR. That would be about a penny and a half, or a penny and three quarters additional cost to you.

Mr. McGINN. Additional cost, sir, that is right.

Senator KERR. All right.

Mr. McGINN. Per drink.

Senator KERR. All right, sir.

Go ahead.

Mr. McGINN. The size of the inventory varies according to the size and type of establishment and according to business patterns followed in various sections of the country.

But a survey among our members indicates that typical tavern and restaurant inventories will be subjected to a floor stocks tax payment varying from $500 to $1,800.

A few can take this payment in their stride, but the great majority will be forced to finance the payment of the tax. The higher the tax, the higher will be the direct cost of doing business.

In closing, it is desired to call to the attention of the committee, section 401 (b) of the House bill.

This is an extremely important provision of the House bill in its application to the small-business men in my industry.

This section would raise the occupational tax from $27.50 to $50—an increase of 82 percent. The Ways and Means Committee stated that the present rate has made it impractical from an administrative standpoint for the Bureau of Internal Revenue to verify the names and addresses of persons paying this tax.

Since the special tax return is now made under the penalties of perjury, the committee's reference to verification in fact means enforcement. The funds raised by this tax are not earmarked for enforcement so it is difficult to find a relation between the amount of the tax and the extent of enforcement activity.

Enforcement is keyed to appropriation and not revenue. We are hopeful that the Bureau will see fit to aggressively enforce this occupational tax because the violators are our unfair competitors—the bootleggers and speakeasys. But there can be no assurance to us in this bill that enforcement appropriations will be made.

It appears to us that the increase of 82 percent would change the character of this tax to a revenue measure which it has never been up to this time.

Senator KERR. That increase from $27.50 to $50, which you mentioned, was that per year?

Mr. McGINN. Yes, sir; an increase of 82 percent.

The amount of the increase cannot be justified by any increase of enforcement cost as shown by the fact that the 82-percent increase would raise $7 million in revenue which is over one-third of the total appropriation of $20½ million which the entire operation of the Alcohol Tax Unit cost last year.

These two subjects are of vital importance to us.

We ask that the committee recommend against an increase in gallonage excise taxes at this time. We believe that the proposed increases would boost illegal sales and bring about a return of the lawlessness of the twenties, force many on-premise retailers out of business, and make our branch of the industry unable to bear its fair share of the over-all-tax burden. We also ask that the occupational tax be left at its present rate.

Senator KERR. All right, Mr. McGinn. Thank you for your appearance.

(The list of affiliates of National Licensed Beverage Association, referred to above, is as follows:)

AFFILIATES OF NATIONAL LICENSED BEVERAGE ASSOCIATION

Arizona Retail Liquor Dealers' Association
Associated Tavern Owners of Brooklyn, Inc.
Associated Tavern Owners of Utah, Inc.
Buckeye Retail Liquor Dealers' Association
California Tavern Association
Cass County Liquor Dealers of Fargo, N. Dak.
Central and Northern California Tavern Association
Chicago Tavern Owners' Association
Hawkeye National Beverage Association
Illinois State Retail Liquor Dealers' Association
Illinois Tavern Owners' Association
Indiana Retail Alcoholic Beverage Association, Inc.
Maryland State Licensed Beverage Association, Inc.
Massachusetts Retail Liquor Dealers' Board of Trade
Michigan Table-Top Licensees' Congress
On-Sale Liquor Dealers of Minneapolis, Inc.
Minnesota Retail Liquor Dealers' Association
Montana Retail Liquor Dealers' Association
Nebraska Beer and Liquor Retailers' Association
New York State Restaurant Liquor Dealers' Association
North Dakota Beverage Dealers Association
Restaurant Beverage Association of Washington, D. C.
Rhode Island Retail Liquor Dealers' Board of Trade
South Dakota Liquor Dealers' Association
Tavern League of Wisconsin, Inc.
United Tavern Owners of Philadelphia
United Licensed Beverage Association of New Jersey
Wisconsin Tavern Keepers' Association
Wyoming State Retail Liquor Dealers Association

Senator KERR. Mr. Benjamin Josephs.

All right, Mr. Josephs.

STATEMENT OF BENJAMIN JOSEPHS, PRESIDENT, NATIONAL RETAIL LIQUOR PACKAGE STORES ASSOCIATION

Mr. JOSEPHS. My name is Benjamin Josephs. I live in Worcester, Mass., where I operate a retail liquor package store.

I appear on behalf of the 44,000 retail liquor package store dealers in this country, as president of their trade group, the National Retail Liquor Package Stores Association. The members of my association, like myself, sell liquor by the bottle.

Most of the 44,000 package store licensees in this country whom I represent, are small businesses, many of them family operations. They rely exclusively on sales of bottled liquor for their livelihood. We are just a few, of course, though an important few, of the hundreds of thousands of small businesses which make up the strength of this country.

I, as a typical package store owner, am very much concerned over the future of my business because of the problems which face me today. I know that this same concern and these same problems face other package-store operators.

These problems stem almost entirely from the weight of the current Federal excise tax on liquor. We are caught on a three-pronged fork:

(1) Shrinking sales.
(2) Rising costs.
(3) A very narrow mark-up.

An unrealistic, uneconomic Federal tax burden, you might say, is the handle of this fork.

My sales are shrinking because the Federal tax has put the price of liquor out of the reach of many people. My sales are also shrinking because of increased competition from the moonshiner—the illegal operator—who is underselling me in my own market.

The incentive to stay in business as a licensed retailer is fast disappearing because my profit is shrinking along with my sales. It is shrinking at a much faster rate because my costs have zoomed. At the same time I am getting less of a profit because my mark-up has been declining since 1942. Since that time the Federal tax has increased 50 percent, from $6 to $9.

This tax is just as much a part of my costs of doing business as my phone bills, rent, labor, insurance, and other expenses, including a high license fee. I have to borrow the money to pay this tax when I buy my goods from the wholesaler and I do not collect it back again until I sell the goods to the consumer some time later.

Senator KERR. You refer to the shrinking volume of business. When did that begin to become apparent?

Mr. JOSEPHS. Shortly after the $9 tax levy. When the tax went to $9.

Senator KERR. What date was that?

Mr. JOSEPHS. I do not have that right here.

Senator KERR. You run your business, don't you?

Mr. JOSEPHS. The $9 tax——

Senator KERR. You run your business, don't you?

Mr. JOSEPHS. Yes, sir.

Senator KERR. Tell us when this decrease in business started?

Mr. JOSEPHS. I would say it has been falling down the last 2 years.

Senator KERR. The record presented here by Mr. Heymsfeld, general counsel and vice president of the Distilled Spirits Institute, showed that, for instance, in June 1950, the sales were $121,000,000 as compared to $107,000,000 in June preceding that period.

Senator TAFT. The House report says during World War II and immediate postwar years consumption of distilled spirits climbed almost continuously in spite of higher liquor taxes and prices reached a peak consumption in 1946, and, as I understand it, the consumption has fallen off since 1946.

Mr. JOSEPHS. Since 1946.

Senator KERR. But has it fallen off since 1946?

Senator TAFT. Yes; it has fallen off since 1946, according to the figures.

Senator KERR. Now the House report refers to the 1950 consumption of $100,000,000.

Senator TAFT. At the time of Korea there was a boost. It declined during the postwar years; since the outbreak of hostilities in Korea, it has again increased, and in 1950 consumption was 190,000,000, which was higher than any previous year since 1945 and 1946, when it reached 230,000,000.

Senator KERR. All right.

Mr. JOSEPHS. I have to borrow the money to pay this tax, and I must pay interest on that money. It is a completely unproductive investment because I have paid the tax on my goods before I sell them. I have a sizable loss if any of my goods break or are stolen. The Government does not refund my tax investment if I drop a case of liquor and break a few bottles.

When I first came into the business in 1934 I sold a bottle of blended whisky for $2.25. At that time the Federal excise tax was $2 a gallon. Today I am forced to ask $4.15 for this same bottle of whisky because today the Federal tax is $9 a gallon, 4½ times what it was when I first went into the business 17 years ago.

Consumers are not willing to pay current prices for whisky and other spirits. Those prices are conditioned by taxes, principally the Federal tax, and there is nothing I, as a local retailer, can do about reducing them. Every time I sell a bottle of blended whisky to a customer for $4.15, he is paying to me $2.18—more than one-half of the purchase price—in Federal, State, and local taxes.

Senator KERR. Are you talking about a quart or a fifth?

Mr. JOSEPHS. A fifth.

The retailers in this country are on the firing line; we are the immediate point of contact with the consumer. We know what the consumer is thinking and what he is saying because we are talking to him. The consumer who used to buy a fifth of whisky every 3 weeks now only buys a fifth every month and a half. I ask him why and he tells me: "I'm sorry, Ben, but I just can't afford it." Or maybe he doesn't come in at all and then I know why: Either he's been priced out of the market completely or else he's taken up with a most dangerous competitor, the illegal operator. I hear the same story from the other retailers in my association when I meet them at conventions or hear from them by mail.

Senator TAFT. Perhaps he has gone to Alcoholics Anonymous.

Mr. JOSEPHS. There are not enough to make that much of a dent.

I understand that 20,000 illegal stills were seized last year. This amounts to about one illegal still for each two package stores. That shows you how strong is the competitive advantage enjoyed by the illegal operator.

I have here a stack of telegrams and letters from practically every section of the country from package-store retailers. They say the increased activity of bootleggers which will ensue from higher taxes will definitely be the extra straw that will push them into bankruptcy or serious financial trouble.

At the consumer level, there is a great deal of resentment. Maybe some of it isn't justified, but the feeling is there nevertheless.

What it boils down to is that the Government has kept boosting the tax until only the wealthy can afford this commodity.

Taxes are forcing ever larger numbers of people to go to bootleggers. We have the contradictory situation of having voted to legalize the sales of liquor and establish rules for its orderly handling and then we see that vote literally nullified by a succession of tax increases which remove it from the purchasers' reach.

This confuses the thinking of otherwise decent citizens and results in an increasing disregard for all laws. You know, gentlemen, there is a point where people begin buying the illegal product not just for the saving involved but to express their resentment of excessive Government taxes and restrictions. That point has been passed in the case of liquor.

At the same time, we liquor people feel that we have been unfairly discriminated against by the Government. We feel unfair advantage has been taken of the fact that liquor is generally considered a commodity separate and apart from all other merchandise and trade. During the war a "temporary" tax was imposed with the promise of relief from it 6 months after hostilities ceased. We accepted this temporary tax in the spirit of the war effort, and took no mark-up on it despite rising costs, thereby lowering our return. Now, 6 years after VJ-day, this temporary tax is still in effect. Our mark-up has not increased. Not only has the promise not been kept but now, instead of lowering the tax, it is proposed to boost it still higher.

The Government now wants to raise the tax from $9 to $10.50 a gallon. That would mean that I would have to finance an additional tax of $1.50 every time I bought a gallon of liquor. It would mean an immediate outlay of a sizable amount of cash to pay for present inventory.

I am a small retailer. Laying out the sort of navy required by an additional tax would create an unreasonable hardship. It figures out to a 16.6-percent increase in my financing costs.

But financing a new tax is only one of the retailers' problems. If sales have already fallen off because of the present tax, how much further will they fall off if the tax goes up another $1.50 a gallon?

Before the last tax increase went into effect my mark-up was 33.5 percent. My mark-up today is 27.5 percent and compares with an average mark-up of 34.2 percent for 51 other lines of retail trade. An additional tax of 26 cents per bottle would shrink my mark-up further to 25.5 percent. Under such circumstances, we could not keep our hands above water very long.

Even the Federal Government, as I understand it, agrees that a new tax would result in a falling off in sales, among other things. That means the State Governments will be getting less revenue in the future than they have been getting. How many of them are going to try tapping the liquor again in order to make up lost revenues? How is the retailer going to survive in this two-way squeeze?

In the meantime, the illegal operator has a field day. He doesn't pay any of these taxes. I am told that in my State today it is possible to buy illegally produced liquor for from $2 to $2.50 a fifth as compared with the $4.15 a fifth I must charge for the legally tax-paid product. A new tax will spread the competitive advantage even wider.

Senator KERR. That is about the present situation?

Mr. JOSEPHS. That is what I have been informed, sir.

Senator KERR. That the fifth of illegally produced liquor is being sold to the consumer at from $2 to $2.50 a fifth?

Mr. JOSEPHS. That is in my vicinity, sir.

Senator KERR. So any thought that the consumer was buying the illegal product at the same price for a gallon of it that he pays for a half pint of the legal tax-paid product was an error to that extent according to your best information, is that right?

Mr. JOSEPHS. Well, my understanding would be that that $1 a gallon would be the cost of manufacture.

Senator KERR. I am talking about the cost that the consumer pays when he buys, and that is what you are talking about.

Mr. JOSEPHS. That is right.

Senator KERR. Thank you.

Mr. JOSEPHS. The package retailers in this country do a pretty necessary job, even though they are low men on the totem pole. They sell to the consumer the distilled spirits produced under Federal supervision by the distiller and distributed by the wholesaler. The Federal Government initially collects its tax revenue from the distiller. If the retailer doesn't sell the product because the consumer refuses to buy it, the distiller pays less taxes to the Government.

If the Federal taxes go any further they will cut into the revenue potentials at all levels of Government not only through reduced excise-tax receipts but through reduced collections from all the other taxes which I and other retailers pay—the Federal and State income taxes, property taxes, franchise taxes, license fees, and occupational taxes.

Finally, gentlemen, I do not believe that the Federal Government would get anywhere near the expected revenue. A tax increase would cut legal sales, stimulate consumption of lawless liquor, and do great damage to thousands of small businesses. All this would have a very depressing effect upon revenue receipts. I hope that the committee will not vote any increase in the excise tax on liquor.

I thank you.

Senator KERR. Mr. Josephs, we thank you for your appearance.

Mr. JOSEPHS. Thank you, sir.

Senator KERR. Mr. Eldredge, please.

STATEMENT OF LAURENCE H. ELDREDGE, CHAIRMAN OF THE BOARD OF DIRECTORS OF PENNSYLVANIA ALCOHOLIC BEVERAGE STUDY, INC.

Mr. ELDREDGE. My name is Laurence H. Eldredge. I live in Bryn Mawr, Montgomery County, Pa., and I practice law in Philadelphia.

I am chairman of the board of directors—without salary—of the Pennsylvania Alcoholic Beverage Study, Inc.

I want to emphasize that I do not and have not at any time directly or indirectly represented any brewer or distillery or vintner.

The Pennsylvania Alcoholic Beverage Study, Inc., is a nonprofit corporation. It was organized in 1940 by a group of citizens who had worked for repeal of the eighteenth amendment and who felt a responsibility to do their part in seeing that alcoholic beverages are made and sold under conditions which serve the public interest.

Since its formation, Pennsylvania Alcoholic Beverage Study, Inc., has been engaged in a continuous and extensive study of liquor control. It has consistently advocated laws to prevent abuses in the sale of liquor. It has consistently favored the vigorous enforcement of the liquor laws. The results of its studies in the field of liquor control are reflected in a book, Making Repeal Work, written by Randolph W. Childs, its executive director and counsel, published in 1947. Attached to this statement is an appendix stating the names and addresses and business connections of the officers and directors of the organization, together with excerpts from newspaper editorials concerning its standing and reputation.

The organization has no interest in the liquor business.

I want to emphasize two points. The first is the unfairness of this tax to the consumer and the attitude of mind that unfairness creates in him.

The second, the serious social implications of excessive liquor taxes.

Liquor taxes are too high right now. A person who buys a bottle of blended whisky for $4 is paying 20 times its production cost. Suppose the proposed rates become effective and a disheartened distiller donates—yes, gives away—his bottled stock to the Pennsylvania Liquor Control Board in my State, and says, "You pay the taxes and sell it."

The Federal tax on a one-fifth-gallon bottle of 100-proof liquor would be $2.40. To this the State would add its mark-up of 48 percent, increasing the price to $3.55.

On top of this the State would add its 10 percent sales tax of 36 cents, bringing the price of this bottle of liquor up to $3.91, merely for the taxes and the mark-up on them. I doubt that the distiller will be quite as disheartened as I have supposed, so in fact, his costs and profit, plus retail mark-ups will also be added to that $3.91, making the total cost well over $5, or more than 25 times production cost.

The illustration involves the sale of a bottle of whisky in Pennsylvania State stores. Substantially the same price increase would be involved if the whisky were sold in any State, whether or not it has the so-called monopoly system.

Under the present tax rates, including State taxes, the man who takes a drink is drinking more taxes than he is liquor. Nothing else which is purchased carries such a heavy tax load. Even if you consider liquor to be a luxury it is taxed out of all proportion to other luxuries. A person who buys a diamond ring or a mink coat pays a 20-percent tax on the retail price which is one-sixth of the total cost. But one-half of the cost of a bottle of whisky, or more, under present rates, represents Federal and State taxes.

Senator KERR. Does it represent a percentage of mark-up which the ultimate seller includes in his sale price?

Mr. ELDRIDGE. The one-half, I think, represents the actual taxes themselves before you get the mark-up on it.

Senator KERR. You think it does?

Mr. ELDRIDGE. Yes; I think it does, because when you add the State taxes on to Federal taxes—I say that is pretty exorbitant even on a luxury product and way out of line with all other luxury taxes, but can you really say it is a true luxury?

We know it is used by 65,000,000 persons in the United States. You can hardly call something a luxury which is used with some regularity by a majority of all adult Americans.

Senator KERR. If you had to place it in the category of either being a luxury or a necessity, in which category would you place it?

Mr. [illegible]. It is like moving pictures, expensive suits, a French hat which my wife might buy; a lot of people think it makes life more pleasant, and I think the average drinking citizen looks upon a cocktail, a highball, a glass of beer, or a glass of wine as one of the normal parts of pleasant living.

I think a good many of your colleagues do, and I do, sir.

Senator TAFT. I understand that over 50 it is purely medicinal.

Mr. [illegible]. I think it has purely medicinal qualities. I will be 50 next March, and I have anticipated a bit.

The average person uses them in periods of relaxation and social life.

He thinks that he is entitled to buy them at a fair price. The man who buys a glass of beer does not understand why he should be subject to still higher taxes while the man who buys a soft drink should escape all Federal excise taxation.

The average man resents the fact that these exorbitant taxes raise the price of liquor to a point where only the man of means can afford to buy it. He resents prices which only the wealthy can pay. It is an unsound tax policy which creates a class of favored customers. Such a policy enforces a kind of prohibition on people of moderate means, while allowing unlimited supplies to the rich.

It is significant that even now the excise taxes fall most heavily upon the drinker in the lower income group, who buys gin and the cheaper brands of whisky. Since the tax is computed on a gallonage basis, he pays the same tax as the consumer of high-quality whisky or brandy. Thus the percentage of tax to the price of a bottle of liquor falls as the price increases. Consequently with high liquor taxes, the average citizen cannot buy gin or whisky at a reasonable price.

The result is that many decent citizens feel that their Government is treating them unfairly.

Some public officials cherish the delusion that the man who wants a drink will pay a price which includes any price that the Government cares to impose.

That attitude is reflected in Deputy Commissioner of Internal Revenue Carroll E. Mealey's statement that:

> If tax-paid spirits are available and the customers have the price, they'll line up in front of the liquor stores to get it.

I challenge that statement. Of course, Mr. Mealey is anxious to support the Secretary of the Treasury. However, even his statement is limited to customers who "have the price." The fact is that most people are hard put to find enough money to pay their income taxes and pay ordinary living expenses at today's inflated prices.

The supposition that consumers of liquor will pay prices for legal liquor which they regard as oppressive and unfair is unrealistic.

Experience shows that when liquor is taxed at prohibitive rates, many citizens will patronize a bootlegger. I would recast Mr. Mealey's statement to read:

> If tax-paid spirits are available only at exorbitant prices, many citizens who cannot afford to pay these prices will stay away from liquor entirely or line up a bootlegger to get it.

As long as the law of fermentation continues to operate, the man who wants a drink can get it. If the legal price is too high, illicit sources will supply what the public wants at a price the public is willing to pay. It is quite irrelevant to discuss whether the consumer is morally justified in patronizing a bootlegger. Experience proves that he will do so rather than pay a price which he considers unfair, or rather than give up drinking.

The fact is that the average citizen does not feel there is anything morally wrong in buying liquor as cheaply as he can get it. He looks upon a law which says such conduct is unlawful as a silly law, which is one reason why national prohibition failed and was repealed.

That attitude creates a lawless state of mind in otherwise respectable citizens and makes them a ready prey for bootleggers. Other witnesses have stated the figures which establish the alarming extent of unlawful distilling under the present rate of tax. Bootlegging is increasing in the great eastern seaboard cities. The proponents of another tax increase admit it will further increase illicit distilling. There is something shocking about increasing tax rates on liquor, in order to increase Federal revenues, when the proponents make this admission.

Even the prospect of a large increase of revenue does not justify a tax which will break down law enforcement and undermine public support of the liquor-tax laws. It is a bad bargain, an immoral bargain, which no amount of additional revenue can excuse.

I know something about the operation of the criminal underworld in a large city. When your colleague, Senator Duff, was Governor of Pennsylvania, he appointed me special deputy attorney general of Pennsylvania to investigate and prosecute the chief magistrate of Philadelphia.

My partner in law gave me a leave of absence, and I gave up my private practice for a period to do that public service.

I had that magistrate indicted on more than 600 separate criminal charges relating to his disposition of gambling and liquor cases. I did not convict him, but during that investigation I learned a lot of things Senator Kefauver's committee has recently found out.

The Philadelphia police are constantly making arrests for the sale of bootleg liquor. In 1949 one of Commissioner Mealey's ATU men said publicly that 5,000 gallons of 180-proof illicit alcohol were distilled daily in Philadelphia. I believe bootlegging has increased since then. This traffic requires the corruption of law-enforcement officials.

In yesterday's Inquirer there is a front-page story of four different arrests in four different locations involving the sale of untaxed liquor; in this morning's Philadelphia Inquirer there is a two-column headline "Two stills raided in north Philadelphia yesterday." These are in addition to the Federal figures, you realize. You cannot have this large-scale bootlegging without some corruption of law-enforcement officials.

In recent years the criminal underworld has devoted itself principally to the gambling rackets profits. But it hasn't forgotten the liquor profits during prohibition and it is getting back into that field. It will go wherever the profits are high enough to justify the risk.

The conservative Evening Bulletin, Philadelphia, stated in an editorial on March 8, 1951, entitled "Bootleggers' Paradise":

> It is now proposed to raise the Federal tax on distilling from $9 to $12 a gallon. The Government needs the money. The distiller can pay it. But an increase of the premium on bootlegging is likely to work great harm. There is a disturbing possibility that the tremendous advantage the bootleg producer would have over the licensed distiller at the new figure would lure organized crime into the bootlegging game on a bigger scale than ever and defy efforts to suppress it.

The only way to prevent future large-scale bootlegging is to keep the profit out of it. You cannot prevent it in any other way. During prohibition, countless thousands of Federal and State enforcement agents tried to suppress bootlegging and it flourished like a green bay tree. We must keep the price of legal liquor down to a point where there will not be enough profit in bootlegging to justify the risks.

The social implications of further increases in excise taxes on liquor are serious and of vast importance. I know of no other tax which has such serious social implications. That is the second point I want to emphasize. It is the principal reason why I have come here.

The present tax rates have created bad social results. Does this committee want to make the situation worse, which is what another increase in taxes will do?

As a lawyer and as a student of government I am deeply concerned with the social effects of any resurgence of bootlegging on a large scale. Any law which the people resent, and which makes lawbreakers of respectable citizens, is a bad law and causes social evil. The prohibition era was an era of unparalleled lawlessness in this country. A large part of our population was openly defiant of laws enacted by the Congress. The Volstead Act created in these people and in the community a spirit of contempt not only for this one law, but for law in general. The worst feature of a bad law is that the lawless attitude it engenders toward itself develops into a lawless attitude toward other laws, and a feeling of contempt for law-enforcement officials.

It is revolting to recollect that many gangsters and criminals of the worst type acquired a certain community standing during the prohibition era and were actually regarded with a sort of admiration.

That spirit of lawlessness, coupled with the fabulous profits which were derived by bootleggers from the unlawful sale of liquor, created a situation which was sickening to every thoughtful student of government. There was wholesale bribery and corruption of policemen, district attorneys, and even judges on the bench. It was a condition which was a threat to everything for which law and order stand.

We can revive, in considerable degree, all those evils of the prohibition era by the sole device of making enough money available to the bootleggers to bribe and corrupt law-enforcement agents and public officials. It is that danger which I fear. It is appalling to contemplate the enormous profit which can be realized by criminal gangs if the proposed tax increases should become effective. We want public opinion against the lawbreaker, not for him. We want public opinion in favor of law enforcement, not against it.

The Congress must not create in citizens a resentment toward their Government and public officials, a belief that it has unfair laws, a belief that lawbreaking is to be viewed tolerantly because of such unfairness.

Our form of government is under attack today in a large part of the world. Here at home the Communists continually bore from within. If the Government by unfair-tax laws creates resentment against itself and develops among the people an attitude of disrespect for law and order, the task of preserving our laws and institutions will be all the harder. It is high time that the Congress took cognizance of the fact that excessive taxes on liquor can breed many kinds of social evil which will weaken our strength in the days that lie ahead of us.

They are days, I fear, which will require our maximum strength as a Nation. They will require a united citizenry, proud of its Government, proud of its laws, proud of its officials, and ready to defend its institutions from whatsoever peril the future may hold.

Senator KERR. We thank you very much for your appearance.

The appendices to your statement will be made a part of the record.

(The documents referred to above follow:)

OFFICERS AND DIRECTORS

Laurence H. Eldredge, chairman of the board of directors, is actively practicing law in Philadelphia and is a senior partner in the law firm of Norris, Lex, Hart, & Eldredge. He is adjunct professor of law in Temple University of law, lecturer on medical jurisprudence in the University of Pennsylvania Medical School, former professor of Law in the University of Pennsylvania Law School, and was twice visiting professor of law in Columbia University Law School. He is author of Modern Tort Problems. In 1948 the American Law Institute appointed him revising reporter for the restatement of the law of torts. He is also reporter of the decisions of the Supreme Court and of the Superior Court of Pennsylvania; president of the Philadelphia Art Alliance; president of Episcopal Hospital, Philadelphia; director and a former president of the Better Business Bureau of Philadelphia; and a former special deputy attorney general of Pennsylvania.

W. W. Keen Butcher, president, is a general partner in the Philadelphia firm of Butcher & Sherrerd, members of the New York Stock Exchange. He is an officer and director of General Waterworks Corp., a director of Missisquoi Corp., and vice chairman of the Committee of Seventy.

Other Philadelphia directors are: K. C. Acton, attorney, director of the Pitcairn Co.; Nicholas Biddle, Jr., insurance; William W. Bodine, Jr., assistant cashier, Tradesmens National Bank & Trust Co.; Edward H. Davis, member of patent law firm of Synnestvedt & Lechner; Thomas Hart, attorney, former president of Episcopal Academy, trustee Lankenau Hospital; Leon J. Obermayer, member of the law firm of Edmonds, Obermayer & Rebmann, and member of the Board of Public Education of the City of Philadelphia; Nathan Pitcairn, The Pitcairn Co.; Raymond Pitcairn, attorney, president of The Pitcairn Co. and director of Pittsburgh Plate Glass Co.; Owen Jones Toland, M. D., Episcopal Hospital.

Directors outside Philadelphia are G. d'A. Belin, Scranton, president of E. I. du Pont de Nemours & Co. of Pennsylvania, Thomas P. Dunn, attorney, Howard M. Fish, president of American Sterilizer Co., and Elmer Hess, M. D., physician and surgeon, former president of Pennsylvania Medical Society, all of Erie; Alexander P. Lindsay, member of the law firm of Sherriff, Lindsay, Weiss & McGinnis, and C. McK. Lynch, broker, member of the firm of Moore, Leonard & Lynch, both of Pittsburgh; Donald Markle, Jeddo, president of Markle Corp. and Jeddo Highland Coal Co., Federico F. Mauck, Norristown, attorney, member of the law firm of Wright, Mauck, Hawes & Spencer; Hon. Thomas W. Phillips, Jr., Butler, former Congressman and Republican gubernatorial candidate in the 1930 primary.

The organization's executive director and counsel is Randolph W. Childs, Philadelphia, a former member of the board of governors and former secretary of the Philadelphia Bar Association, member of the law firm of Adams, Childs, McKaig & Lukens, author of Making Repeal Work.

Richard E. Prevall is assistant to the executive director.

PRESS COMMENTS

Pittsburgh Press, February 10, 1948:

"Pennsylvania Alcoholic Beverage Study, Inc., probably has the soundest and most useful ideas and criticisms of the liquor system, year in and year out, of anybody concerned with this problem."

Pittsburgh Press, December 27, 1948:

"Alcoholic Beverage Study, Inc., is a nonprofit, nonpartisan, nonofficial organization of citizens interested in keeping the liquor traffic clean."

The Evening Bulletin, Philadelphia, February 6, 1951:

"The Alcoholic Beverage Study is an association of public-spirited citizens who keep a vigilant eye on enforcement of liquor control."

The Sunday Bulletin, Philadelphia, June 24, 1951:

"The Pennsylvania Alcoholic Beverage Study is a privately supported organization which serves a commendable public purpose in keeping an eye on the operation of liquor control in the Commonwealth.

"It has no discernible partisan objectives. It has been a useful critic of errors in administration and a forthright champion of rigid law enforcement."

Pittsburgh Press, May 10, 1948:

"The Man Who Watches the Liquor Business: Mr. Eldredge, in an accurate sense, is a public-spirited citizen. What he does in the public interest, as he sees it, he does solely for that reason—plus, probably, the satisfaction of trying to do something constructive. He gets no other fees for his trouble. His best known activity, aside from the practice of law, is Pennsylvania Alcoholic Beverage Study, Inc."

Senator KERR. Mr. Harry L. Lourie.

STATEMENT OF HARRY L. LOURIE, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF ALCOHOLIC BEVERAGE IMPORTERS, INC., WASHINGTON, D. C.

Mr. LOURIE. Mr. Chairman and members of the committee, my name is Harry L. Lourie. I am executive vice president of the National Association of Alcoholic Beverage Importers, Inc., 700 National Press Building, Washington, D. C.

The association is a membership, nonprofit organization, organized under the laws of the State of New York. Our members, we estimate, bring to the United States more than 80 percent of all the imported alcoholic beverages taxpaid for sale in our country.

At the hearings held by the Committee on Ways and Means on excise taxes on alcoholic beverages on March 12, 1951, I presented a statement in behalf of importers of alcoholic beverages which summarized the special position of importers of alcoholic beverages in our national economy.

I am attaching a copy of that statement for the benefit and information of members of the Senate Finance Committee.

At this time, I desire not only to reiterate the facts presented at the hearings before the Committee on Ways and Means, but to add some material supplementing that statement.

Imported alcoholic beverages represent a small portion of the total business devoted to the production and distribution of all types and kinds of wines, spirits, and beers. The general economic problems of the entire industry just as much the concern of importers of alcoholic beverages as of the distilling and wine trades. The relationships may be summarized as follows:

(1) All imported alcoholic beverages pay the same internal revenue taxes as are applied to like and similar domestic alcoholic beverages.

Senator KERR. Mr. Lourie, there has been the suggestion that the tax should be on a percentage basis. The average price of imported whiskies is higher than the price on those produced domestically, isn't it?

Mr. LOURIE. It is partly higher because we pay a tariff on all imported products, not only on the beverage, but on the container.

The price we are paying for Scotch whisky today is no higher than the price in 1930 and 1934.

Senator KERR. What about the price with reference to the cost of domestically distilled and sold whiskies?

Mr. LOURIE. At the present time I can only quote the prices in what we call the fair trade market like New York.

Senator KERR. Do you know whether or not you pay an average amount which is higher on the imported whisky than on the average whisky in this country?

Mr. LOURIE. The present price in Scotland runs about $12 per case.

That is the price f. o. b. Scotland. To that we add the cost of freight, ocean insurance, and the Federal taxes, which I thought I would cover later on in the statement.

Senator KERR. Go right ahead.

Mr. LOURIE. (2) All imported alcoholic beverages are distributed through wholesale and retail distributors in the same manner as is used for the distribution of domestic wines and spirits.

(3) Wholesalers and retailers, restaurants and hotels, all distribute both domestic and imported alcoholic beverages.

(4) The general economic conditions of our country have the same general effect on the production, importation, and sale of all alcoholic beverages.

(5) The laws and regulations of the United States Government and the various States apply equally to all alcoholic beverages whether of domestic or foreign origin.

(6) The success or failure of the import branch of the industry depends on the same important factor which determines success or failure for producers and distributors of domestic alcoholic beverages—the ability to provide the ultimate consumer with a first-class product at a reasonable price.

(7) The only tax difference in the case of imported alcoholic beverages is that all imports pay a tariff on the particular alcoholic beverages and its container—if imported in glass bottles—in addition to the excise tax provided for like and similar domestic items.

Senator TAFT. What does that tariff amount to?

Mr. LOURIE. The tariff at the present time is $1.50 per gallon on Scotch.

Senator TAFT. $1.50?

Mr. LOURIE. $1.50.

The tariff varies a little. In the case of brandies, cordials, and liquors, it is $1.25, and in the case of champagnes it is $1.50.

In the case of certain imported wines it is different.

Senator FREAR. That is a domestic gallon or an imperial gallon?

Mr. LOURIE. That is a United States gallon.

This association realizes that despite the important role played by imported alcoholic beverages in aiding the rehabilitation of Western European countries and the British Isles in bring about economic recovery, imported alcoholic beverages cannot be singled out for preferential treatment for excise taxes. Whatever decision is made for the rate of excise tax on spirits, wines, and beers will result in the application of identical taxes to all such products regardless of origin.

For that reason, this association respectfully requests that the Senate Finance Committee in its deliberations give careful consideration to the following points which we believe summarize the difficult position of the entire wine and spirit trade.

(1) Prior to 1944, the internal revenue taxes on distilled spirits had been progressively increased from $1.10 per proof gallon to $6.60.

In April 1944, a war emergency increase was imposed of $3 additional tax making a total of $9 per gallon. This additional tax was earmarked to be removed when the President of the United States proclaimed the cessation of hostilities. The intention of the Congress to have the additional tax of $3 treated as a temporary emergency tax was confirmed not only in the report filed by the Senate Finance Committee at the time, but also by the action taken at a later date by the Congress when it adopted a law setting up the machinery to be put into motion when the President proclaimed the end of the war and the emergency tax was removed. The particular law in question provided for a refund of the equivalent of the $3 tax on all tax-paid spirits in the possession of distillers, wholesalers, and retail distributors.

(2) The alcoholic beverage industry has been a favorite source of revenue for our Federal and State Governments under both peacetime and wartime conditions. The recommendations of the Secretary of the Treasury with respect to increasing excise taxes on distilled spirits were accompanied by an explanation indicating that the Treasury Department felt that there would be a decline of approximately 12 percent in the consumption of legal distilled spirits if the tax should be increased from $9 to $12 per proof gallon. The Treasury Department failed to explain exactly what a decline in consumption of 12 percent would mean to the national economy.

(3) The State and local revenues from alcoholic beverages in the calendar year of 1949 amounted to $686,000,000 for the States and $60,000,000 for local authorities. A decline of consumption of 12 percent would result in financial embarrassment for many of the State and local authorities, since there has been a great deal of reliance on the revenue obtained from alcoholic beverages by States, cities, and counties, for the raising of funds needed for general purposes.

If the States and the local authorities attempt to offset the decline in their revenues by further increases in their local taxes, a tax spiral will be set up which ultimately would defeat in major portion the objective of raising substantial revenues for Federal, State, and local governments.

(4) The Treasury Department has not particularly emphasized the tremendous growth in illicit distilling and distribution which has occurred since the end of the war. That there has been an enormous development in such illicit distilling and distribution is recognized by State and Federal authorities and is definitely confirmed by the reports of seizures of stills issued by the Alcohol Tax Unit, of the United States Bureau of Internal Revenue, as well as by the various States.

Senator TAFT. Do you find any increase in illegal importation?

Mr. LOURIE. We have no record of any seizures of any illegally imported alcoholic beverages since 1935, if my memory serves me correctly.

Senator TAFT. During prohibition days they were certainly very numerous.

Mr. LOURIE. Very numerous.

The Deputy Commissioner of the Alcohol Tax Unit reported that in the fiscal year ended June 30, 1948, his department had seized 5,654 stills, 40,880 wine gallons of non-tax-paid distilled spirits, and 1,700,000 wine gallons of mash. In the fiscal year ended June 30, 1950, the Commissioner reports that the Alcohol Tax Unit had seized 10,030 stills, 140,000 wine gallons of non-tax-paid distilled spirits and 4,892,000 wine gallons of mash.

In addition, it is estimated that the seizures of illicit stills made by the individual States during the same period amounted to approximately 8,000 stills. Thus, in the fiscal year ended June 30, 1950, approximately 18,000 illicit stills were sized.

There appears to be sufficient information to indicate that the illicit operators are not local in the main, but rather that there has been recreated an illicit industry comparable in volume to that which existed during the prohibition era. There has been an increase in the number of stills with large capacity in and near important metropolitan areas. No figures are available to indicate the total volume of illicit distilled spirits produced and distributed by illegal operators and the total revenue which Federal, State, and local authorities lost.

A common-sense yardstick may be applied. If we presume that the lowest capacity of an illicit still is 100 gallons a day, then the 18,000 stills estimated to have been seized in the fiscal year ended June 30, 1950, would represent a day's output of approximately 1,800,000 gallons, which would mean a loss to the Federal Government if these stills operated for only 1 day of $16,000,000.

We know that an illicit still operates for more than 1 day before it is seized. We know from Alcohol Tax Unit report that the average capacity of the still seized is more than 100 gallons. We also know from the statistics issued by the Alcohol Tax Unit that despite the large numbers of stills which have been seized since 1945, increasing numbers are still being located and seized. Evidently there has been a tremendous loss to Federal, State, and local governments because the existing tax is so high as to make it possible for illegal operators to engage in illicit production at a profit despite the large number of stills seized by Federal and State authorities.

(5) The solution to the illicit industry does not rest solely with increased enforcement and increasing the number of enforcement officials. The heart of the solution must depend on removing the tax incentive which already exists under the $9 tax and which certainly would be greatly stimulated if the tax on distilled spirits increases further.

In the statement made before the Committee on Ways and Means, we pointed out that based on the price paid by the importers in Scotland for Scotch whisky, the effective rate of the combined internal revenue taxes and tariffs amounted to 181 percent during the calendar year of 1950, and for Canadian whisky amounted to 188 percent of the price paid in Canada.

We also pointed out the important role imported wines and spirits played in the creation of dollars needed by countries such as England, France, Italy, and to a much smaller extent, Germany, for the purpose of supplies in the United States.

Our international trade in these commodities may be maintained only if prices the consumer pays are reasonable. The impact of the present taxes on Scotch whisky, for example, amounts to $25.20 per standard case of 12 four-fifth quarts. This is the equivalent of $2.70 per bottle and does not include any of the State taxes.

The only change in price to consumers since 1939 for Scotch whisky has come mainly from increased internal revenue taxes, although there has been a slight increase in ocean freight rate charges.

Our position may be summarized as follows:

We feel that if the sole objective of the Federal Government is the obtaining of revenue, then the wine and spirit trade should not be called on again for the collection of increased taxes. In the calendar year of 1950 the Federal Government received from alcohol taxes $2,419,000,000.

The alcoholic beverage industry made the largest contribution of any industry and was exceeded only by corporation and individual income taxes. If the objective of heavy taxes on the alcoholic beverage trade is to reduce consumption, we feel that such an objective will never be attained, since it will only result in increasing illicit operations. It is our belief that where a national emergency exists, the tax base should not be restricted to a few selected industries which have been determined as excellent sources of revenue, but that the problem of financing a national emergency should be solved by widening the application of taxes of all sorts and types, so as to include, as far as possible, all of the people in the United States, rather than those persons who are engaged in special or specific trades.

It is estimated that approximately 2,000,000 people are directly or indirectly working in the alcoholic beverage industry. It is known that all of the companies, whether they are large distillers, or small local retail package stores, pay corporation and income taxes to the Federal Government as well as their State business taxes.

If an increase in the present taxes is adopted by Congress and there results the anticipated decline in the consumption of legal spirits, there also will be the additional result of reduced corporation and individual income taxes from the persons engaged in the industry.

It is our view that the present taxes are much too high and that Congress should consider carrying out the provisions in the Revenue Act of 1943 when it declared definitely that the increased taxes were emergency taxes to be removed when hostilities ceased.

Senator KERR. Mr. Lourie, we thank you. The appendix to your statement will be made a part of the record.

Mr. LOURIE. Thank you.

(The appendix referred to is as follows:)

STATEMENT OF HARRY L. LOURIE, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF ALCOHOLIC BEVERAGE IMPORTERS, INC., BEFORE COMMITTEE ON WAYS AND MEANS

Mr. Chairman and members of the committee, my name is Harry L. Lourie. I am executive vice president of the National Association of Alcoholic Beverage Importers, Inc., 700 National Press Building, Washington, D. C. The association is a membership, nonprofit organization organized under the laws of the State of New York. Our members, we estimate, bring to the United States more than 90 percent of all the imported alcoholic beverages tax-paid for sale in our country.

Imported alcoholic beverages, in addition to paying the tariff rates set forth in the Tariff Act of 1930, pay the same internal revenue taxes as are paid by like and similar domestic articles. It, therefore, follows that since in addition to the taxes which are imposed by the Revenue Act of 1948, we pay rates of tariff, the taxes collected on imported alcoholic beverages by the United States Government are decidedly greater per unit than is true in the case of similar domestic items.

Prior to the adoption of the Revenue Act of 1917, imported distilled spirits paid a tariff of $2.60 per gallon, but paid no internal revenue tax. The Revenue Act of 1917 was a First World War measure and carried a provision for the collection of existing internal revenue taxes on all imported alcoholic beverages.

When prohibition was repealed in December 1933 the rates of duties provided for in the Tariff Act of 1930 were identical with those carried in the Tariff Act of 1922. The rates were extraordinarily high because at the time of the enactment of the Tariff Act of 1922 prohibition was in effect in the United States. There was no import industry for alcoholic beverages and the small amounts which came here, and were permitted entry into the United State for consumption, were to fill prescriptions issued by doctors. As a result, the tariff rates were set at extraordinarily high figures.

Under the various trade agreements, these high tariffs have, for many of the imported wines and spirits, been reduced. At the present time the tariff on imported whiskies is $1.50 per gallon. In addition, the excise tax of $9 is also collected.

It is our view that in considering the rate of tax to be imposed on alcoholic beverages it is not possible to reach a final figure without studying basic facts and without determining not only possible revenue but also the effects on the industry.

The trade agreement program recognized the necessity of developing mutual trade between the United States and other countries since only through mutual trade, moving as freely as possible, with a minimum of impediments, could the United States hope to maintain a reasonable export trade.

The end of the last war brought home forcibly to our country the important stake it had in the building of sound economic systems in Western European countries as well as in the United Kingdom. The Marshall plan was adopted for that purpose. The import trade in alcoholic beverages is of decided value to the British, Canadian, French, and Italian Governments in creating dollar credits to be employed in the purchase of needed materials in the United States. We believe that the proposed tax on distilled spirits should be scrutinized carefully by the committee in order to determine what effect the adoption of the tax might have on the dollar accounts of the countries which have found in the exports of their special distilled spirits a quick and immediate source for establishing dollar credits in the United States.

Our position may be summarized in the following points:

(1) The proposed tax of $12 per gallon on distilled spirits will mean in the case of imported whiskies such as Scotch and Canadian whiskies a Federal tax of $32.40 per standard case of 12 ⅘-quart bottles, as compared with the existing tax of $25.20. It is our view that the proposed tax is extraordinary in its nature. It amounts to $2.70 per bottle and, of course, does not include State taxes. The extraordinary amount of the proposed tax may be visualized by the committee if it can imagine a situation whereby importers could buy Scotch or Canadian whisky for nothing, bring it to the United States for nothing, and offer it to wholesale distributors at the exact amount of the tax of $32.40 per case. Allowing a wholesaler his usual gross margin and the retailer in turn his usual gross margin, it would mean a retail price of $49.68 per case or $4.14 per bottle without including State taxes. Remember that this figure is based on the proposed Federal tax and does not include anything for the cost of the whisky, the cost of transportation, insurance, the cost of operating an importer's establishment, the cost of moving the goods from the port of entry to consuming centers in the United States, the cost of making sales, etc.

(2) The United States Treasury Department has been the principal beneficiary of the import trade, and the amounts the Treasury has received are far in excess of the dollars paid various foreign producers. For example, in the calendar year of 1950 there was tax-paid in the United States Scotch whisky valued in Scotland at $56,231,000. The United States Government collected in taxes, at the rate now existing, $101,535,000. You will thus note that the rate of tax was 181 percent of the price paid by the importers.

In 1950 the Canadian whisky tax-paid in the United States was valued in Canada at $31,112,000. The United States Government collected on this Canadian whisky a tax of $58,592,000, or at a rate of 188 percent of the price paid in Canada by the import trade.

These figures demonstrate that the benefits our country has sought to make available to the United Kingdom and Canada through trade agreements have also resulted in a large return to our own Government greatly in excess of the dollars paid by importers for the particular whiskies.

(3) Will the imposition of the proposed $12 tax have any serious effects?

We believe that there is bound to be a decline in the consumption of these items in the United States. Thus, although the United States Government may receive revenue equal to or perhaps greater than under present conditions, there is little doubt that the dollars received by the foreign governments will fall decidedly. It is, for example, possible for the consumption of Scotch whisky in the United States to decline 25 percent without any drop in the tax receipts shown at the $9 rate. However, a decline in the consumption of Scotch whisky of 25 percent would mean a very sharp drop in the dollars the British Government would have available for expenditures in the United States.

What will the effect be on the 250,000 retail establishments which sell to consumers alcoholic beverages by the bottle or by the drink?

Here is a group of small-business men, small retailers operating under limited capital and under limited credit facilities. An increase in the tax on Scotch or Canadian whisky from $25.20 to $32.40 per case will result in a serious financial burden for these small companies.

Under the system employed in collecting the tax, the goods handled by these retailers have all been tax paid in advance of sales to consumers. In other words, the industry pays the Federal taxes to the Treasury Department and then proceeds to collect the taxes from the consumers. Every one of these small companies must have sufficient financial resources to enable this advance tax payment. For that reason, the position of these operators should be given most careful consideration. They are not in the same position as other retailers handling jewelry, luggage, furs, or cosmetics. Those retailers advance no taxes to the Government, but at the time of sale collect a 20 percent tax from the buyer. When you consider the enormous portion the Federal tax represents of the price paid by the retailer for the alcoholic beverages he sells to consumers, you will realize that his financial problem is not easy to solve. Here again, we are not including the State taxes which, of course, the retailer also has to advance.

Ever since 1946, the volume of business done by the average retail package store has declined. We are advised that the economic position of the small neighborhood tavernkeeper has been sharply impaired since 1946. There is nothing mysterious about the application of the Federal taxes on alcoholic beverages and who pays the taxes. Although they are paid for in advance of sale, ultimately the taxes are paid by the consumer. It is reasonable to assume that if the sale of distilled spirits declined so sharply under the existing tax system since 1946, increasing the tax from $9 to $12 will certainly not act as an incentive, but will result in a further decline. To the retail business enterprise in our field, the proposed tax represents a definite possibility of not only financial difficulties in handling the tax, but in a sharp decline in actual volume of business coming at a time when all costs of operation have been going up.

We feel that the most careful consideration should be given to the retailers' position and to the danger of bankruptcy to many of these small-business men.

What of the States?

All of the States receive considerable revenue from the alcoholic beverage industry, principally through gallonage taxes and, for some States, through the adoption of State store systems. If the increased tax should result in a drop in consumption, as is anticipated, the revenue receipts of the States will be impaired. The tax history of this industry indicates that whenever States have found a drop in revenue, they also consider an increase in tax. That happened after the sharp decline in consumption which came in 1947.

(4) We feel that the alcoholic beverage industry should not be turned to again for increased taxes. We recognize the needs of our Government. We are willing to pay our share. There must be a limit to the amount of taxes which may be collected from any one industry. Some members of the committee may recall that when the emergency taxes of 1940 were being considered, we recommended that the excise taxes be left unchanged and that a consumers' sales tax be collected at the time of sale. We renewed this recommendation at the hearings

held in 1941. We feel that such a tax on a percentage basis would be flexible in nature, since it could be increased or decreased in accordance with the Government's needs and would avoid imposing on the industry, especially on the 250,000 small retailers, the heavy burden of financing in advance the excise taxes collected on alcoholic beverages. We feel that serious consideration should be given to our views that the tax burden now carried by the alcoholic beverage trade should not be increased.

Senator KERR. Mr. Sweet is our next witness.

STATEMENT OF FRED SWEET, REPRESENTING HOTEL AND RESTAURANT EMPLOYEES AND BARTENDERS INTERNATIONAL UNION, AFL

Mr. SWEET. Mr. Chairman, if you will permit me, I should like to reduce my statement a little bit in order to save your time.

Senator KERR. That is all right. You have the time allotted you, and we shall be glad to stay here for that time and listen to you.

Mr. SWEET. My name is Fred Sweet, of Cincinnati, Ohio. I appear here on behalf of Mr. Miller.

Our union wishes to briefly give our views on certain proposals in H. R. 4473 for increasing the revenues of the Federal Government.

We shall confine our comments to a single, narrow concern—the impact of the proposed new levies on the lives and fortunes of the 2,000,000 men and women employed in the Nation's hotels, restaurants, and taverns.

We have in mind three basic points:

(1) To increase taxes on alcoholic beverages is to put on the street thousands of workers employed in our industry.

You will understand that our jobs are, to an extraordinary degree, dependent upon the legal sale, in licensed premises, of freely available, popular-priced beer, wine, and spirits.

For example, bar receipts in the Nation's hotels currently amount to 17.7 percent of their total sales. The ratio of bar income to the total sales of licensed restaurants is a good deal higher. And you know that most businesses, especially the small, close-margin operations common in our industry, one dollar in eight is more than the difference between solvency and the arrival of the sheriff with a brand-new lock.

Since so important a part of the receipts of the places where we work derives from the bar, and since price rises tend to cut down buying, it follows that any increase in the prices of these beverages will tend to reduce the need for our services.

Already the entertainment side of our industry has found it necessary to lay off kitchen and dining-room workers by the thousands, in many cases shutting up shop, as the public rebelled against the 20-percent tariff on night-club checks. We know that the public will stop coming as often to our places of work if new taxes are added.

Nor are we concerned alone about the direct threat of these tax proposals to our jobs. There is the additional threat to all of us as consumers. The figures show that the United States market for alcoholic beverages runs to some 65,000,000 adult Americans, of whom 80 percent are wage earners.

Senator KERR. How many adult Americans are there?

Mr. SWEET. There are 150,000,000 Americans and I can't take my family as typical because I have four children.

Senator TAFT. You can't find it that way. Roughly speaking, it is about 63 percent, I think.

Mr. SWEET. 63 percent.

Well, 63 percent of these adults—there are a good deal more than 65,000,000 adult Americans.

Senator KERR. I wondered if you had that figure.

Mr. SWEET. I do not have the figure on the tip of my tongue.

What will these millions do when you have taxed out of reach the legal bottle of beer, or the friendly dram, available through supervised, licensed, taxpaying channels?

The overworked men of the Alcohol Tax Unit over at the Treasury know full well what many are doing even now, for the ATU men are out on the firing line, trying to contain the burgeoning bootleg business which has moved from the tall timber and the mountain creeks into the metropolitan markets. These men know that the history of the twenties is already repeating itself as the public seeks out the cheaper, tax-free product of the illegal producer through channels which have no supervision but the tommygun.

Our second point is this: To add excise taxes on any consumer goods including alcoholic beverages, and at the same time to clap another levy on the family earnings of these workers already caught between the millstones of frozen wages and rising prices, is to compound their misery in the way quite out of keeping with the traditional United States tax policy of seeking revenues from those most able to pay.

An excise tax is a sales tax. It is quite like the retail sales tax imposed in my own State, except that excise taxes are generally figured in the merchant's cost when he calculates his mark-up, so that we find ourselves paying not only the higher taxes but an added sum to boot.

To find such increases in a tax bill which includes as well a plan to take another big bite from the take-home pay of the low-wage earner is a shocking blow. It is shocking because, by using the method of multiple taxation, it reveals that the Congress is being taken in by the bland theory that the way out of our troubles is to "drain off excess purchasing power" by pumping dry the purses of the poor.

There is an old adage about taxing that some people think has practical content. "Pluck the goose," says this old saw, "that squawks the least."

But the adage offers no formula for where you turn when the bird is picked so clean that you have killed the goose that lays the golden eggs.

You are killing the goose when you pile still more taxes on the most heavily burdened commodities in our economy, alcoholic beverages.

You are performing the same short-sighted operation when you say to a worker in these low brackets, "We are going to raise your income taxes. Then we are going to hike the tariff on your kitchen clock, your electric iron, your radio, and your beer. We are doing this for your own good, to get rid of your excess purchasing power."

How much "excess purchasing power" has the Louisville waitress on 25 cents an hour, the New York dishwasher on $45 a week, the Sioux City cook on $55 a week?

Tell any of these he is a threat to the national economy because he has more money than he needs to pay the butcher, the landlord, and the doctor—and he will laugh in your face.

In their names we urge you, look elsewhere for your new revenues than in here—in these barren budgets of such as these.

(3) Finally, we wish to protest with all the vigor at our command what we believe to be a pair of "sleepers" in the alcohol tax clauses of this bill. Both are perhaps unsuspected but important collateral effects of this measure. They are, first, the use of the pressure of taxes to squeeze manpower out of an essential industry like so much toothpaste from a tube. The other is the use of the taxing power to gain what cannot be won by the ballot—a sharp reduction in the use of these products as a roundabout road to prohibition.

When this proposal to raise the taxes on alcoholic beverages was first made by Secretary Snyder, the Cincinnati Enquirer, pointing out that these rates were already sky high, added a pointed warning that any more taxes on these products would mean "Prohibition for the masses, but not for the classes."

We remind you of the British example. Back in 1901 the tax on a gallon of spirits in Great Britain was 11 shillings, and consumption in that year stood at 45 million gallons. Today that same gallon of spirits carries a tax of 10 pounds—and consumption in the British Isles has fallen to 8 million gallons.

Senator KERR. You say that the British tax on spirits is 10 pounds to the gallon?

Mr. SWEET. Ten pounds plus to the gallon, sir.

Senator KERR. All right.

Mr. SWEET. Are there those drafting tax laws in Washington who would impose through the taxing power what they cannot establish by the ballot—a return to prohibition? We think this proposal goes a long way toward just such a backward movement for America.

But even more immediate is the other concern of our people employed on licensed premises. Washington is searching for manpower for the defense industries. We believe that one effect of this bill will be to put so powerful a squeeze on workers in our own essential industry as to force scores of thousands of them into the job market.

While many of our people have skills useful in the machine and other defense industries, a very large number do not, having spent their working lives in these service trades. Such people will be the real victims of this squeeze play.

There is much to support this view. The wage freeze is relaxed for industrial workers, but not for workers in the service trades.

Congress and the States adopt laws to protect other employees but leave the service workers out in the cold. Our people because they are not believed to be or held to be in interstate commerce are denied the guarantee of a 75-percent minimum wage under Federal law. And now it is proposed that we be harried out of our jobs by taxing beyond the public's reach the commodities we are employed to serve that public.

Thank you.

Senator KERR. Thank you, sir. Our next witness is Mr. Erwin B. Hock.

STATEMENT OF ERWIN B. HOCK, DIRECTOR, DIVISION OF ALCOHOLIC BEVERAGE CONTROL, STATE OF NEW JERSEY

Mr. HOCK. My name is Erwin B. Hock. I am director of the Division of Alcoholic Beverage Control of the State of New Jersey, and what I have to say before your committee is based on 16 years' experience in liquor control in my State, first as deputy commissioner in this agency, and since 1947, as its head.

Both as a public official and a citizen of the United States, I recognize the necessity for finding additional revenue to meet the added cost of national defense. As I see it, the question under consideration here is whether further across-the-board increases of excise taxes on alcoholic beverages should be adopted and, if so, what effect increases would have with respect to the public interest.

The persistence of the tax-evading manufacture of distilled spirits more than 17 years after repeal—and its mushroom growth today—in my opinion is directly attributable to the heavy tax burden on legal liquor.

Taking into account other levies such as Federal occupation and rectification taxes and State and local taxes over and above the present $9 proof gallon excise taxes on distilled spirits, the tax burden on legal liquor today totals nearly $12 per gallon.

As against this, it is generally accepted that tax-evading distilled spirits can be produced under current conditions for $1 a gallon or less. Obviously the wide differential presents an open invitation to violation and evasion of the law. It constitutes a protective tariff for the bootlegger. Any further increase in taxes on distilled spirits can only aggravate the difficult problem of liquor control.

Governor Driscoll, my predecessor as State commissioner of alcoholic beverage control, told the New Jersey Association of Chosen Freeholders, at its annual dinner on February 5, 1951—

> A sharp increase in alcoholic beverage taxes would certainly result in more bootlegging with a resultant tax loss to the States and an increase in the cost of law enforcement.

A further increase in Federal excise taxes must necessarily increase the price of alcoholic beverages to the consumer, thus inviting many of our citizens either to drink less, spend more for what they drink, or patronize illegal sources. Unfortunately, our experience during the prohibition era indicates that rather than drink less or pay more, many of our citizens would resort to the bootlegger.

During the early years of repeal, Federal, State, and local enforcement agencies expended great efforts, and with marked success, to stamp out the illicit activities which carried over from the prohibition era.

In subsequent years much of the illicit activity was confined to small-scale operations. During the last few years, however, and particularly in recent months, have come indications that the more ambitious, large-scale illicit activity is being resumed.

Senator KERR. The present tax has been on since 1944?

Mr. HOCK. That is right.

Senator KERR. You think that the impact of it has only begun to be felt in recent months?

Mr. HOCK. No. I think the tax went on in 1944, the last increase. That was during the war years. During those early years after that increase we had a war situation where materials were not available to illicit still operators for some time, and that kept down the illicit operations, in my opinion.

After 1945, things began to pick up a little bit, and there was more activity, but still on a small scale. But during the last year and particularly since January 1 some very large stills have been seized in the northeastern part of the country and arrests have been made.

Senator TAFT. Since the Kefauver committee started to operate.

Mr. HOCK. No; I do not think the Kefauver committee had anything to do with these still raids.

Senator TAFT. I do not think so, either.

Mr. HOCK. I would say about the Kefauver committee that many of the people who were mentioned during the course of that investigation had old prohibition records; and one of the concerns——

Senator TAFT. You think they may be connected with the more ambitious large-scale activities that are now being resumed?

Mr. HOCK. I think if they are driven out of their present sources of revenue, they might well go back to their old sources of revenue.

Senator KERR. Is it possible that decrease in consumption in the last 12 months, if that is a reality, as has been indicated, is traceable to other causes than a continuation of the same rate of taxation during the past 12 months that had been on it the 6 years prior to that?

Mr. HOCK. I question that there has been a serious decrease in consumption.

Senator KERR. Of legal liquor.

Mr. HOCK. I think there has been maybe of legal liquors. But I do not think that people have stopped drinking who had been drinking.

Senator KERR. I am talking about the decrease in the consumption of legal liquor in the last 12 months referred to. I ask you if it is not entirely possible that that could have been caused by other things than the continuation during that period of the same tax Federalwise that had been on it for 6 years prior to that time.

Mr. HOCK. Very probably certain economic conditions carry some factor in reduction.

Senator KERR. In giving consideration to this, every factor is entitled to be taken into account, but an intelligent consideration of it would not give a greater amount of consideration to an element than it is entitled to receive or than it should receive in relationship to the other elements that are involved. You would agree with that?

Mr. HOCK. Yes, sir; I would.

Senator KERR. All right. I am very interested in everything you have to say here.

Mr. HOCK. Since January 21, this year, my division has seized 11 stills in New Jersey, 7 of which were large commercial operations—one having a daily capacity of 1,000 gallons of high-proof alcohol.

There is also evidence that these large commercial tax-evading operations are being conducted on an organized syndicate basis. On May 18, 1951, a large commercial still was raided by Federal agents near the city of Baltimore and among those arrested at the site of the still were three New Jersey residents, one of whom was a familiar figure in illicit liquor operations during prohibition.

As recently as July 17, a 1,000-gallon still was raided in the State of New Hampshire. Two of the four men arrested in connection with this illegal operation were also from New Jersey and one has a prior record of illicit liquor operations in my State.

Senator KERR. You do not say that your boys in New Jersey have enforced your laws so well that you have kind of scattered them?

Mr. HOCK. We would like to think that. I would say during the prohibition era New Jersey was rather famous for its still operations.

Senator TAFT. It still may be the center of the operations.

Mr. HOCK. I think we have a lot of trained operators who have carried over from prohibition and have gone out to other areas for operations, though we have some in our State that operate there.

Those who participate in illicit liquor business do not balk at interstate transportation. State enforcement officials are deeply concerned over the accumulating evidence of increased illicit liquor activities and the indications of organized group activities. Because of this State liquor enforcement officials from Maryland, Delaware, the city of Baltimore, Pennsylvania, New Jersey, New York, Connecticut, and Rhode Island, conferred in New York City on June 6 and June 20, 1951, to discuss ways and means of coping with the problem. It was unanimously agreed that State boundaries are no barrier to illicit liquor operations; that increased illicit liquor activities necessarily result in disrespect for law generally and a weakening of our control systems; and that increased tax-evading activities necessarily result in loss of revenues to the State.

As a result of this conference a program has been set up for the interchange of all available information on illicit operations along the eastern seaboard, from Maryland to Rhode Island. It is our hope that through cooperative effort we may alleviate this problem which has grown up around the present tax burden.

With respect to wine: It is generally accepted that our greatest consumption of wine is among persons of foreign origin or foreign extraction. Undoubtedly an increase in taxes on wine, which would increase the cost to the consumer, might very well drive thousands of people to home manufacture of the product with a resultant decrease in tax revenue and an increase in enforcement problems. Even under current conditions, my division frequently finds instances of wine being illegally manufactured in homes and then being illegally sold.

With respect to beer: Although I do not believe that an increase in excise taxes on beer would bring back the days of home brew, I look upon beer as the modest drink of the workingman and believe that a further increase of malt alcoholic beverage taxes would do him an injustice.

In addition, a further increase in the cost of this product to the consumer as a result of increased taxes might very well cause many consumers to become ready customers of the illicit whisky operators. There was much evidence of this during the prohibition era, when numerous preprohibition beer drinkers were converted to hard-liquor consumers.

In reviewing the entire problem of an across-the-board increase in alcoholic beverage taxes, serious consideration should be given to the additional financial burden placed upon the alcoholic-beverage industry, particularly the many thousands of small retailers throughout the country. If the proposed increases on the various alcoholic beverages were adopted, it would mean that every licensee would need substantially more money to finance his business. Obviously this would place an onerous load upon the small licensees throughout the Nation and would probably force many of them either to go out of business or resort to practices inimical to the public interest.

The law in most States where the sale of alcoholic beverages is legalized provides that one of the primary responsibilities of liquor administration is the promotion of temperance. I am convinced that liquor administration can best carry out this responsibility where there is an orderly distribution of alcoholic beverages to members of the public and where the legal beverages are made available at a reasonable price. Our years under prohibition were the most intemperate in our history. Inordinately high taxes may not have the sound of prohibition, but I am convinced that a further increase in Federal taxes would result in great intemperance because of increased quantities of illicit alcoholic beverages distributed at bargain prices without control.

The public generally realizes that both Federal and State Governments require increased revenue. It does not follow, however, that a substantial share of this increase should be placed upon an industry which already carries so heavy a tax burden. It is the time-tested truth that a lower tax widely distributed produces more revenue than a high tax, the incidence of which falls solely upon a special class. It is my firm opinion that even greater revenue than is anticipated by the presently proposed increase in excise taxes on alcoholic beverages may be obtained by strengthening enforcement under the present rates and by imposing more severe penalties against violators. The solution will not be found in merely increasing a tax on a commodity so long as the potential producing capacity of tax-evading still exceeds the production of legal distilleries.

Senator KERR. All right, Mr. Hock. We thank you for your appearance.

Mr. HOCK. Thank you, sir.

Senator KERR. Is Mr. Frank Sims here?

Mr. SIMS. Yes, sir.

Senator KERR. Mr. Sims, how much of a statement do you have?

Mr. SIMS. Ten minutes, sir.

Senator KERR. All right, sir. Come forward.

Identify yourself for the record, and proceed.

STATEMENT OF FRANK K. SIMS, JR., EXECUTIVE VICE PRESIDENT, NORTH CAROLINA ALCOHOLIC BEVERAGE CONTROL ASSOCIATION

Mr. SIMS. My name is Frank K. Sims, Jr., Charlotte, N. C.

I would like to say that I became interested in the question of the control of alcoholic beverages while serving as judge of the municipal criminal court in Charlotte, N. C., and then as a member of the General Assembly in North Carolina, sponsored and fought for legislation that might strenghten the control system in our State.

I am now chairman of the Mecklenburg County Alcoholic Beverage Control Board in North Carolina and also the executive vice president of the North Carolina Alcoholic Beverage Control Association. North Carolina is one of the 17 monopoly States, where liquor is sold only through government stores. But in our State the monopoly system operates on a county rather than a State-wide basis, and the revenue obtained goes primarily to the counties, not to the State.

Senator KERR. Do you have local option?

Mr. SIMS. Yes, sir.

Senator KERR. In what part of the State——

Mr. SIMS. Thirty-three counties are now under the alcoholic beverage control system.

Senator KERR. How many counties do you have?

Mr. SIMS. One hundred.

Senator KERR. That means 67 counties—in those counties it is illegal to sell?

Mr. SIMS. That is correct.

Senator KERR. All right.

Mr. SIMS. I very much appreciate the opportunity of appearing before the members of this Committee on Finance, and although I am not empowered to speak on behalf of the other monopoly States in this country, I assure you gentlemen that the interest which I express in the Federal tax proposals on distilled spirits is undoubtedly equally shared by other monopoly States.

There are several points related to monopoly revenue problems and the dependence that essential government activities have on liquor revenue that I would like to discuss with this committee. It is widely recognized that today our State and local governments are facing a serious problem in finding additional sources of revenue to pay for the essential services provided for their citizens. The fact that the Federal Government has access to sources of revenue that are not available to State and local governments must be taken into consideration. Furthermore, even where commodities are subject to tax by the State and local governments, this usually means that State levies must be made over and above Federal taxes, so that prices are increased to a point that often leads to diminishing returns at both levels. In behalf of North Carolina, now faced with the problem of finding a way to increase revenues from new and old sources, I urge you gentlemen to consider the liquor tax proposal in terms of the effect it would have on State budgets.

It seems worth while citing to you the share that is contributed by liquor revenues to the total tax collections of several of the monopoly States. North Carolina, for example, with no private licenses derives 7 percent of its total revenues from sales and taxation of alcoholic beverages.

Senator KERR. You are talking about the local governments in North Carolina, or the State?

Mr. SIMS. I am talking about the State in that instance. That is what they get.

Ohio derives 11.8 percent of its total revenues from alcoholic beverage income, Pennsylvania, 18.6 percent; and Virginia, 15.5 percent.

These funds are allocated to a variety of State programs, such as education, old-age pensions and assistance, and school-lunch programs, and so forth.

For the calendar year 1950, Alabama, for example, applied its alcoholic beverage revenue as follows:

Cash payments

To State general fund	$6,191,841.80
To State public welfare	200,000.00
To counties general fund	1,084,804.41
To counties public welfare	200,000.00
To municipalities in which stores are located	820,770.20
To all incorporated municipalities	9,020,704.80

Senator KERR. Does that figure include the preceding one?

Mr. SIMS. No, sir; that is separate.

Senator KERR. All right.

Mr. SIMS. In another case the State of Washington appropriates the money received from liquor sales, taxes and license fees to its cities and counties and, notably, to the University of Washington and Washington State College.

Thus, it is apparent that liquor revenues contribute substantially to the operation of State programs and to the well-being of the people of these States.

Another aspect of the problem for the monopoly States is the impact of a Federal tax increase on revenues of States and counties whose budgets are already heavily burdened by increasing costs of operation. A Federal tax increase will undoubtedly result in decreased legal consumption. Under the present tax, sales to consumers have already dropped markedly since 1946.

Senator KERR. Is the all-time high in 1946?

Mr. SIMS. I think that is the leveling-off point, sir. I do not think that is the all-time high.

Senator KERR. Has it been higher than that since?

Mr. SIMS. I do not think for a full year. I think there have been periods during a year.

Senator KERR. The $9 tax was put on in 1944.

Mr. SIMS. The last tax was put on in 1944.

Senator KERR. The present tax?

Mr. SIMS. Yes, sir. The $9 tax.

Senator KERR. So that the consumption continued to increase through 1945 and 1946.

Mr. SIMS. Until the year 1946.

Senator KERR. Then the leveling-off started, and it went down, and then in 1950 it was almost back up to 1946.

Mr. SIMS. Yes, sir.

Senator KERR. All right.

Mr. SIMS. If taxes push the retail price of liquor any higher, the legal product will go out of the reach of any purchasers who today are hard-pressed by higher costs of food, rent, clothing, and so forth.

When the Federal Government on April 1, 1944, imposed an increase of $3 per proof gallon—termed a war tax to be removed at the end of World War II—the counties of North Carolina absorbed some of this increase, just as they had absorbed a portion of the 1942 increase of $2. We felt that to pass these increases on to the public would seriously reduce our sales and greatly encourage and increase the manufacture and sale of illicit nontax paid whisky. As a result, profits have been reduced to an absolute minimum. Any further in-road would eliminate the incentive of the county control system as far as revenue is concerned.

Any further increase in the tax on distilled spirits will certainly mean continued losses to the States and counties—losses which must be counterbalanced from some source in order to maintain adequate State programs for health, welfare, and education.

I would like to interpose to say that Georgia is an outstanding example of how high taxes result in bootlegging and lost revenues.

In 1946 the State raised the liquor tax from $1.20 to $4 a gallon. Georgia revenues dropped from $18,000,000 to $10,800,000.

The next year they dropped to $9,400,000. Then in 1949 in order to offset falling revenues the tax was raised again from $4 to $5 a gallon. But by the end of 1950 revenues had fallen 55 percent, while seizures of illicit stills in Georgia by Federal agents alone increased 45 percent from 1,305 to 1,904.

Finally, on April 2, last, under the recommendation of the revenue commissioner, there was a drastic tax reduction from $5 to $2 a gallon.

The results of that tax reduction are striking.

The department of commerce figures show that in April 1951, Georgia had an increase of 92 percent in sales over the previous month, and in May there was an increase of 49 percent over April.

Stamp sales in Georgia in May 1951 were 119,172 as against 83,263 in May of 1950 and were 208,000 in June 1951 against 128,000 in June 1950.

Senator KERR. What other revenues do they get besides stamp sales?

Mr. SIMS. The State has a gallonage tax.

Senator KERR. Besides the stamps?

Mr. SIMS. Besides the stamps.

Senator KERR. All right.

Mr. SIMS. It is of interest to know that our county of Mecklenburg alone paid the Federal Government $10,056,017.35 in excise taxes on the sale of whisky during the first 42 months of operation. The present $9 tax has amounted to 60.47 percent of the total cost of the whisky sold.

Senator TAFT. You mean you manufacture it?

Mr. SIMS. No, sir; that is the percentage of what we pay the distillers for the whisky.

Senator TAFT. That is not paid in Mecklenburg County?

Mr. SIMS. No, we pay that to the Federal Government.

But that represents 60 percent of our cost merchandise.

Senator KERR. How much do you mark it up?

Mr. SIMS. We started off with a 50-percent mark-up. It is now actually a 26 percent mark-up, because we have absorbed some of these taxes. The original tax prior to the tax in 1942 is figured in by the distiller. Then since the $9 increase, that is paid separately. We pay that separately.

Senator TAFT. When you say you pay, you mean you pay the distillers that much, and they then pay the Federal Government?

Mr. SIMS. Yes, but we have to pay that tax when we get the whisky.

Senator TAFT. I understand that.

Mr. SIMS. The biggest problem facing the ABC Association today is the illicit manufacturing of non-tax-paid "moonshine" whisky in North Carolina. Within the past 3 weeks agents of the Alcoholic Tax

Unit have captured and destroyed the two largest illicit stills ever caught in North Carolina. One of these had a capacity of 714 gallons—a loss to the Federal Government of $6,426 every day it operated at capacity. The other, in a small county in eastern North Carolina had a capacity several times the total amount of legal liquor sold in that county in a day. The price of such whisky in North Carolina is approximately $3 per gallon at the still.

I am being very generous allowing for their profits. It varies from $1.50 on low-grade whisky to $2 on average grade whisky and $3 for their best quality moonshine.

Senator KERR. How does that quality compare with what you sell?

Mr. SIMS. We do not think that it compares at all. At $3 a gallon, they double and twist it and run it through at about 120°, and that brings a premium. You can get it with a little creek water in it and it will sell for $15 a case, $12 to $16 a case. That is 6 gallons the way they handle it. It will average around $2 to $3.

Senator TAFT. Is it bottled and gotten up in an attractive style?

Mr. SIMS. No, sir. It is all in fruit jars. In some States it is much less. The Federal tax alone on legal whisky is $9 per gallon. Thus it is obvious that any increase in Federal tax would encourage the moonshiner and the bootlegger.

Any increase in the illicit whisky traffic will make definite inroads not only in profits now accruing to the North Carolina counties, but also in the taxes paid the Federal and State Governments.

We are spending a large part of our profits for law enforcement and will continue to do so, but any increase in taxes on legal liquor will make our law-enforcement efforts far more costly.

Senator KERR. You state you spend a large amount of your profits for law enforcement. Do you think you make enough profit from the sale of liquor to pay for the increased law enforcement that it requires?

Mr. SIMS. We, in our county, Senator—I will answer by saying that is my interest. My interest is in law enforcement. I am not connected with any distiller, have no interest in the industry.

In our county we will spend any amount necessary, and when I took the job as chairman, I said I would spend a hundred percent of the profits if necessary to enforce the law. We, in Mecklenburg County, consider that to be the excuse for our existence. We are spending between 5 and 10 percent of our net profits—that is, after paying our Federal taxes and after paying our State taxes, which is 8½ percent on top of the Federal taxes, and everything else.

We, in our county, which I think is outstanding—and I will brag to the extent that I think I have the best law-enforcement agency in the country. The ATU has been kind enough to say the same thing. We can police our county. We will spend whatever money is necessary, but we have this mountainous country up there where the bootlegger is fast coming back into his own, and that one still I mentioned, there is no way of estimating how long it had been operating. That is our only problem in North Carolina.

I am wiling to spend every dime of my profits for law enforcement. We have adopted a slogan which is, "Control of the sale of alcoholic beverages by law rather than leave it in the hands of outlaws."

Outlaws are about to run over us when they can compete with us. In my section economically we can't pay the Federal Government

$10 a gallon for tax and expect our industrial workers—and we have some low-paid industrial workers—we can't expect to compete with $2 and $3 a gallon bootleg liquor brought in there from the mountains.

Senator KERR. We recognize that.

Mr. SIMS. That is the situation.

Illegal distilling operations serve as an impetus to crime, especially since the "moonshiners" have developed the technique of delivering their product by using the dangerous "hot rod" cars. These are a menace on the highway, as any driver will testify, and the curbing of their use means still more work for local officials and more danger for law-enforcement officers.

We contend, gentlemen, that any increase in taxes on liquor will serve in effect to subsidize the illegal operator and create a situation which will be extremely difficult to control with the present staff available in most localities. Therefore, in our opinion, any action which would discourage legal sales of liquor, already on the decline because of the present tax rate, would be most harmful to the interests of the monopoly States.

The primary responsibility for control and enforcement is vested in the individual State governments by the terms of the twenty-first amendment to the Constitution. The control and enforcement activities, however, require the availability of appropriate moneys. Thus it seems a reasonable inference that State governments should also enjoy the availability of liquor revenues through taxation, monopoly profits, and other appropriate sources, in order to help them discharge their responsibilities to the people.

For all these reasons, I believe that any increase in Federal excise tax on liquor would work contrary to the best interests of the monopoly States. I hope that no increase will be adopted.

Thank you, gentlemen.

Senator KERR. Thank you very much for your appearance.

The Chair inserts a letter from the Department of Finance and Taxation of the State of Tennessee and a statement of Guy C. Shearer, chairman, the Kentucky Alcoholic Beverage Control Board, in lieu of personal appearance, in the record at this point.

STATE OF TENNESSEE,
DEPARTMENT OF FINANCE AND TAXATION,
Nashville, July 27, 1951.

Hon. WALTER GEORGE,
Chairman, Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: I understand that on next Monday your committee will consider the matter of the proposed increase in alcoholic-beverage taxes.

In my official position, I am charged with collecting the State's revenue on alcoholic beverages, the regulation and control of licensees, and the destruction, insofar as possible, of the "moonshine" industry.

We have a constant battle in the Southeastern States, with our half-wet, half-dry situation, to keep down the traffic in "moonshine" liquor. It can be curtailed, and with the assistance of the Federal Alcohol Tax Unit, we have to some extent curtailed it in this State; it cannot be eliminated without prohibitive enforcement costs.

I believe that increased taxation of alcoholic beverages will inevitably increase the economic incentive for "moonshine" production and will increase "moonshine" consumption, and along with it, to some degree, decrease the consumption of lawful beverages. I believe that this factor should be carefully considered by your committee in arriving at its conclusion.

I fully realize that the need for revenue, and the sources thereof, are very broad issues, and on them I make no comment.

I will appreciate your filing this letter as a part of the record of your committee hearing.

Respectfully,

JAMES CLARENCE EVANS, *Commissioner.*

WRITTEN STATEMENT OF GUY O. SHEARER, COMMISSIONER-CHAIRMAN OF THE KENTUCKY ALCOHOLIC BEVERAGE CONTROL BOARD

I am Guy O. Shearer, commissioner-chairman of the Kentucky Alcoholic Beverage Control Board. My statement is one of protest against the recommended $1.50 per gallon raise of the excise tax on whisky to $10.50 per gallon.

I will not discuss the economic or State tax features or figures with this committee as others will cover those features. Nor will I discuss or interpret in detail the fact that 10,000 illicit whisky stills were seized in 1949, capable of producing 520,000 gallons of whisky per day. The capacity production amounted to almost 120,000 gallons more per day than was actually produced in 1949 by the legal taxpaying distilled spirits industry.

As Government and industry statistics on whisky are endless, I am going to leave those to others more qualified than I. However, it is my duty as commissioner of the Kentucky board to direct field operations in the endless fight on illicit whisky production.

Our State of Kentucky, with its rough terrain, mountains, thousands of small streams, 2,500 miles of navigable rivers, and 10,000 miles of caves, many of which have streams and rivers in them, is ideally situated for the illicit manufacture of whisky. Our geographic advantages have not been neglected by the illicit whisky producers, as Kentucky generally ranks among the top eight States in illegal whisky production. Kentucky is also the Nation's leading producer of legal whisky.

In the past 3 years your Federal Government, through its excellent Alcohol Tax Unit of the Treasury Department has made a wonderful law-enforcement record in Kentucky. Our State alcoholic department has cooperated with and tried to assist them in this work.

As an enforcement official and citizen, I am greatly concerned over the fact that by the proposed $10.50 per gallon excise tax on whisky, the Federal Government may be buying revenue at too great a price.

This proposed legislation was undoubtedly designed for the purpose of obtaining additional revenue for the Federal Government rather than for the purpose of bringing about a prohibition of legal whisky for the average consumer.

The anticipated and estimated revenue is probably the sincere opinion and the work of the tax, revenue, or Treasury expert. It is the competent, sincere expert that estimates and the Congress that levies the whisky excise tax but it is the consumer that in the final analysis determines the actual revenue return from such taxation. Mr. Consumer is the paymaster.

A sufficiently high but fair excise tax on whisky is good for the Federal Treasury, acceptable to the average consumer, but is destructive for the unlawful manufacturer (moonshiner), transporter, and bootlegger.

The maker, transporter, and seller of illegal whisky cannot prosper unless, and until they have an opportunity to do so. They cannot and will not have the opportunity to prosper without a market for their product. There can be no adequate market for these illegal operators unless one is created for them.

The two things that can, do now, and will continue to create such a market is (1) a shortage of legal whisky, or (2) an excessively high price on legal whisky to the consumer. More than half of the present high price of whisky to the consumer is the result of the now existing high Federal excise tax. When legal whisky has an excessive retail price, be it the result of an overburden of taxation on the product or any other cause, the average consumer begins to feel justified in buying an alcoholic product illegally produced. His preference for legal whisky and his sales resistance to illegal whisky is eradicated by the great differential in price. In the prohibition era, it wasn't the fact that one couldn't get legal whisky that brought about the big-time moonshiner, rum-runner, and underworld boss. It was the price that the consumer had to pay for legal whisky. The purchaser of legal whisky had to first pay for the prescription that would permit him to make the legal purchase and then proceed to buy the legal product. Those of us on State liquor boards that have been called in and consulted by authorities relative to what disposition should be made of cases or half-cases of prescription whisky left as part of the estate of some wealthy decedent, realized that legal whisky was available for those who could pay the price in the prohibition era. From these observations of the prohibition era, we get some idea what to expect as a result of excessive excise-whisky-tax legislation. While the proposed excise-tax legislation might produce some additional revenue, it will also go a long way toward bringing about prohibition of legal whisky for the Mr. Average Man of the consuming group.

Since the richest prospect for the manufacture and seller of illicit whisky is at present, and will continue to be (unless present taxes are lowered) the middle class, the average every-day fellow, it is appropriate that we consider the now-existing taxes on the product.

Exclusive of barreling, storing, aging, bottling, labeling, and marketing present whisky production, costs range from $1 per gallon to $1.25 per gallon. The liquor taxes are 10 times the actual cost of production. Federal, State, and local taxes total from $10.84 to $15.00 per gallon. Such is the cost of legal whisky that now goes to market in competition with illegal whisky, the production cost of which is from 60 cents to 90 cents per gallon, and is free from any tax, Federal or State.

In the light of these facts, is it surprising that bootlegging is now more prevalent than when the excise tax was only $6 rather than the present $9 per gallon? In the light of these facts, wouldn't the Congress be justified in keeping the commitment made and included in the original $9 excise tax on whisky to the effect that the $9 tax would be again lowered to $6 per gallon when the World War II emergency had terminated? It's a most unusual product that can never be taxed enough. The Federal excise tax on a gallon of whisky has increased 800 percent since 1942. It is $9 now as compared with $3 in that year. The tax on whisky is greater than the tax on any other luxury item.

The fact that bootlegging is more prevalent than when the excise tax was $6 indicates an overburden of taxes. It has not been and will not be the tax burden, but the tax overburden that kills the legal whisky sale.

In the prohibition era, we learned, and the history of mankind discloses, that, be they rich or poor, "the thirsty find drink" in some form. The alcoholic beverage consumers' desire for spirituous drink will be attained, be the drink a legal or illegal product, or be it fit or unfit for human consumption.

In my opinion, if the $10.50-per-gallon excise-tax legislation passes, it will not only bring out the hillside moonshiner, the home-distillery assembly units, formerly used in prohibition days to make a little whisky for the family and a few neighbors, but moonshining will again move into the big-time business classification.

From the raise of the present excise tax from the $6 to $9 level, we see signs that the present excise tax is now excessive. In 1949, illegal still seizures totaled 370 in Kentucky, and the State ranked eighth in still seizures. In 1950 there was an increase to 500 stills, with a capacity of 34,545 gallons per day, that were destroyed. Three thousand nine hundred and eleven gallons of moonshine were seized and 45 automobiles and seven trucks became the property of the Alcohol Tax Unit as contraband and 500 arrests were made.

Within the past 4 months, a still having 1,500 gallons per day capacity was seized within 22 miles of Louisville. This was the largest still that the Alcohol Tax Unit had seized in Kentucky in the past 15 years.

It is my opinion, which is based on 15 years in Government; on the experience of having grown up in the prohibition era, on the experience of approximately 15 years as a practicing attorney, and 3 years as chairman-commissioner of the Kentucky Alcoholic Beverage Control Board, that—

1. The estimated revenue from the pending excise legislation will not be nearly as great as anticipated;

2. As the price of legal whisky is increased, and the differential between legal and illegal whisky grows greater, the whisky consumers' sales resistance to illegal whisky is reduced proportionately;

3. That so long as whisky is legally sold, it should be kept within the price range of the of the average consumer;

4. The pending $10.50-per-gallon excise tax should be defeated;

5. That if the $10.50-per-gallon excise whisky tax act passes, the big-time moonshiner, rum-runner, and bootlegger will again become a tremendous problem;

6. That numerous newly created enforcement problems at the Federal, State, and local levels, will necessitate large expenditures of money and the employment of many men thereby depleting our national manpower that will be sorely needed elsewhere during the present emergency;

7. That the Federal excise tax should be lowered to $6 per gallon.

It is to be remembered that excise tax, whether it be State or Federal, is derived only from the sale of legal whisky.

BONI, WATKINS, MOUNTEER & CO.,
New York, N. Y., August 1, 1951.

The Honorable WALTER F. GEORGE,
Chairman of Finance Committee,
United States Senate, Washington 25, D. C.

DEAR SIR: As an economist with a keen appreciation of the fateful import of the deliberations of your committee on current fiscal policy, I venture to proffer a brief economic analysis of what appear to be the main issues at stake. In the course of the discussion some suggestions are advanced which I hope you may find promising, and may even be inclined to put to a practical use.

Between April 15, 1950, and April 15, 1951 (date of latest available figure for comparisons here in view), the all-commodities wholesale price index rose exactly 20 percent. In the same period, business loans of commercial banks rose 40.5 percent and the amount of consumer credit outstanding (installment loans) 14 percent, while currency in circulation remained virtually unchanged. The result was a net addition, during the year, of $7.1 billion to means of payment for goods and services. But gross national product (seasonally adjusted at annual rates), expressed in constant (1939) dollars, was actually lower by 0.68 percent in the quarter ending March 31, 1951, than a year earlier ($182.2 billion as against $183.1 billion). These facts plainly spell inflation and clearly point to its major source.

An increased quantity of means of payment running after a decreased volume of goods and services leads to higher prices, unless the means of payment "run slower" (money circulates less rapidly) than before. However, as the volume of money chasing goods increases, the likelihood is that its rate of circulation will also increase. While no official data are available on recent changes in the rate of currency circulation, FRB data on deposit turn-over (for weekly reporting member banks) disclose a rise, during the year ending March 31, 1951, of 20 percent in the New York City banks' rate and of 16 percent in that of banks in "other leading cities." Thus, the inflationary effect of the increase in the quantity of money (through credit expansion) without any increase in the volume of goods and services to be exchanged (bought and sold) was compounded by a sharp rise in the "efficiency" of money. In such circumstances, attempts to "freeze" prices are, at best, futile.

Control of the supply of money is one of the sovereign functions of government. The Federal Government's primary responsibility for the inflation that has occurred in the past year should be clear. It was in position, as was no other body or group, to halt the expansion of credit—which constitutes the largest part of money supply. Tardily it has taken steps in this direction: By raising bank reserve ratios, by restricting consumer credit (including real-estate credit) and, most important of all, by discouraging the "cashing" of Government bonds (especially by bank holders) through "unpegging" their prices and permitting interest rates to rise. It has also, within recent weeks, encouraged an organized movement for voluntary restriction of bank credit, which is already showing salutary results. Whether these several measures are sufficiently rigorous to check the inflationary forces that were earlier allowed virtually to run rampant is an open question. But that they came too late to prevent a sharp decline in the purchasing power of the dollar is obvious.

The damage inflation has already done, however, cannot be undone. The question now is whether the general public is to be exposed to the same "pickpocket" operation on an even bigger scale henceworth, or, to be more definite, say in the next 12 months. Taking due account of the genuine (though none too rigorous) anti-inflationary measures now in force, the danger that it will be is great. The grounds for this conclusion can be better appreciated in the light of a brief review of the circumstances that prompted the credit-implemented buyers' stampede of the past year. Beyond question, the specific "circumstances" were the Korean outbreak and the ensuing rearmament program. True, these developments led to no immediate large-scale increase in Government expenditures involving an expansion of the money supply. But "coming events cast their shadows before them." In this instance the coming events were anticipated acute goods shortages and sharply higher prices. Few people apparently, recalling 1940–41 experience, could believe that the Government would be foresighted enough to enforce the necessary retrenchment on the demand for men, machines, and materials in the production of civilian goods and services to enable military procurement officials to "draft" sufficient productive resources to fulfill the rearmament program (at home and abroad) without forcing up prices. Hence came about the wave of "scare buying" by consumers and inventory accumulation by business, much of it credit-financed.

Thus the inflation of the past year was occasioned by the mere "shadows" of prospective rearmament expenditures. It owed nothing to a budget deficit, for there was none. In fiscal 1951, the Treasury's cash intake was $7.3 billion greater than its cash outgo, and even on a budgetary basis its excess of receipts over expenditures amounted to $3.5 billion. Though Federal fiscal policy manifestly was not a cause of the inflation during this period, it might have been used more effectively than it was used to combat an inflation having its roots elsewhere.

Parenthetically, the ardent advocates of a pay-as-we-go fiscal policy might well reflect on these facts. Just as the Government's financial rectitude in "living within its income" in the past year did not forestall inflation, so a temporary lapse of balanced budgeting in the coming year would not necessarily promote inflation. A tax program designed to stimulate private savings could divert purchasing power from civilian goods and services markets quite as effectually as a tax program designed to reduce purchasing power so disposable. With equal efficacy from the standpoint of preventing inflation, the Government can obtain part of the funds required for defense expenditures out of real savings transferred to the Treasury through bond purchases or it can obtain all of them through higher taxes. The only fundamental difference between these two methods of relieving inflationary pressures on civilian goods and services markets is that in the one case the public secures something in return for the purchasing power currently foregone, specifically, a promise of future repayment, whereas in the other case it gets back nothing—except perhaps a feeling of virtue from sacrifices endured.

Inasmuch as to fulfill the promise of future repayment of the bonds, with interest, the Government will be obliged to levy heavier taxes hereafter than it otherwise would, it might appear that it is a matter of indifference, from the viewpoint of the public as a whole, which of these alternative methods of financing rearmament is adopted. This is by no means so. In the first place, cultivation of habits of thrift yields lasting benefits to any economy, and especially to a private enterprise economy. Poor Richard's advice was not meant for the eighteenth century alone; it is still good counsel for the twentieth. Secondly, by contributing to the solidarity of a democratic society, there are advantages in making patriotic sacrifices formally compensable. The Congress has wisely recognized this principle in the GI bill of rights. It would earn credit for itself, and strengthen popular faith in democratic government, were it to apply the same principle in respect to some part of the economic sacrifices entailed by rearmament.

Though the cost of building up a Defense Establishment adequate for national security must, in one way or another, be borne by the present generation, the deprivations it entails can be enormously lightened by holding out to those (all of us) whose real income is thereby lessened a compensatory claim on future income. It could be argued, of course, that from the viewpoint of the public as a whole the "future income" from which reimbursement is to come is our own, so that the "compensation" (in the form of Government bonds) for current income foregone is illusory. In a sense, this is true. But "the viewpoint of the public as a whole" is likewise in a sense illusory. In a democratic society the public is not a homogeneous mass of undifferentiated persons. It consists of individuals, each with distinctive traits, capacities, and ambitions. Earning power and the kind and amount of accumulations vary incontinently. Such being the case, the size and composition of the saving group and of the taxpaying group are far from identical.

So it does not follow that a fiscal program for the emergency aimed at a just balance between higher tax levies and Government borrowing of increased real savings, in preference to an uncompromising application of the pay-as-we-go shibboleth, is illusory. On the contrary, it offers genuine, long-run economic advantages of a kind that are preeminently worthy of congressional solicitude in unsettled times like the present.

To return now to the main theme, the defense program will shift into high gear in fiscal 1952 (year ending June 30, 1952). Estimated defense expenditures will nearly double those of fiscal 1951, rising from an average monthly rate of $2.9 billion to one of $4.8 billion. The diversion during the year ahead of an extra $23 billion worth of goods and services from the civilian market to the military can only be accomplished without further inflation by reducing civilian demand. (In view of the actual decline during the past year in the total real output of goods and services and of the prospective absorption by the military services of about 3 million men, we assume here that, at a maximum, increased productivity cannot offset a rise of real output in the coming year by more than 4 percent. This would be equivalent to a rise of say $8 billion in 1939 dollars or $19 billion in current dollars.) The two levers at the Government's command for accomplishing such a reduction are fiscal and monetary. (In an emergency, the materials allocation device is indispensable for assuring adequate military supplies. But as it does not directly reduce civilian demand, we omit it here.) If the foregoing analysis is correct, to avoid further inflation the Government will need to use both levers more vigorously than heretofore.

The simplest and most effective way to reduce civilian demand is to reduce business expenditures on nonmilitary production (including investment) programs. Consumer expenditures will take care of themselves if business expenditures are properly regulated, for the wherewithal of the former has its principal source in the latter. And by and large restriction of business expenditures on civilian production programs can be most expeditiously and economically enforced by restriction of bank credit. In existing circumstances, it would be imprudent, for this purpose, to trust exclusively to Federal Reserve open market operations and voluntary compliance with the recently organized movement to curb bank loans to business. Statutory authorization is clearly expedient for imposing higher reserve ratios if need be, for extending FRB control of reserve ratios to nonmember banks, and for implementing the FRB proposal to institute secondary reserves freezing part of the bank holdings of Government securities. These measures judiciously administered would go far to abate the dangers of further inflation.

The fiscal lever can and should be used in three ways: By cutting Federal nonmilitary expenditures, by increasing anti-inflationary taxes, and by stimulating both private savings and their investment in Government bonds.

(1) The Government can economize in its own demands on the limited available supplies of men, materials, and machines by diverting to rearmament a substantial part of the funds now being spent on scores of civilian activities that are not essential to defense. Indeed, retrenchment in the Government's civil expenditures, in some directions, would eliminate flagrant wastes known to all men. Outstanding examples are afforded by the rivers and harbors pork barrel, agricultural subsidies, and mail subsidies to periodicals.

(2) The Government can obtain an even larger contribution to defense costs by turning the tax screws a bit tighter. It is important to remember, however, that not all taxes are equally anti-inflationary. In the present context, i. e., as a means of counteracting inflationary forces implicit in a sudden, radical increase in military expenditures, the most efficacious taxes are those that have a minimum adverse effect on current production and a maximum tendency to promote saving. It is a common mistake to overlook, in this connection, the role of investment. The frequent declaration that a sound taxation policy, in the present emergency, will repress consumption is no more than a half-truth. Investment is no less inflationary than spending. Indeed, dollar for dollar, it is far more inflationary, as Keynes was at pains to emphasize. So diversion of savings, both individual and corporate, from civilian goods and services markets (including construction goods and services) to Government bond purchases is a necessary part of any program for strengthening our military defenses without weakening our economic defenses.

Probably the individual income tax provides the most efficacious and equitable fiscal means of diverting available purchasing power from civilian markets. But it should not be overlooked that whatever part of personal income-tax revenues would have been saved had the tax collector not got them represents a depletion by so much of the supply of funds the Treasury can tap by its bond issues. Accordingly, to provide a salutary stimulus to individual saving, it would appear advisable, while reducing personal exemptions and increasing moderately the applicable rates all along the income scale but especially in the middle brackets, to deduct from taxable income life insurance premiums and all or some part of the funds used to buy United States savings bonds. Limits are already in effect on the latter channel of investment, and to prevent misuse of the former maximum deductions therefor might well be stipulated. Such a tax measure would make a higher income tax rate much less unpalatable and presumably have less adverse effects on production incentives than the increased rates otherwise might. At the same time it would provide a direct and powerful inducement to spend less and privately invest less and to save more and buy more Government new issues. (And given a continuation of the Treasury's acquiescence in an upward movement of interest rates, undoubtedly a large proportion of insurance companies' liquid investment funds would flow into "Governments," new or old, in either case helping to turn back the inflationary tide.)

Though the corporation income tax is less anti-inflationary than the individual income tax, its more rigorous use in the present emergency would help appreciably to close the inflationary gap. This is particularly true if the device were used in conjunction with effective credit control measures, as suggested above. For then resort to bank borrowing as an alternative source of funds would be impeded, if not blocked. But the frequent allegation that the entire burden of corporation income taxes is simply shifted to consumers in the form of higher prices cannot be sustained. In their very nature such taxes bear unequally on different enterprises competing in the same market, and in few industries is the market position of every competitor strong enough to permit each to recoup the full amount of the levy.

Parenthetically, we do not minimize the long-run disadvantages of a levy that cuts down corporate savings and the volume of earnings "plowed back," or reinvested. Under ordinary conditions any advance in the high corporation income tax rates now in effect would clearly be uneconomical. But when the paramount consideration is to shift men, materials, and machines to defense production, a check to plant expansion in civilian goods lines is a sine qua non of preventing inflation. For the goods shortage that such plant expansion programs might relieve is a future shortage. To construct additional facilities for civilian production now is to give the 1951 economy a double-barreled inflationary charge: increasing consumers' disposable income and decreasing the means of production available for the defense program (not to mention preventing, by so much, an increase in the current supply of consumers' goods).

Probably the least anti-inflationary taxes of all are excise duties and so-called excess-profits levies. Both are highly discriminatory and inequitable. On economic no less than social grounds, with two exceptions their repeal forthwith would be an all-round gain. The exceptions are the excises on liquor and tobacco. Because these products have no close substitutes and because to the extent that their consumption is repressed few question the benefits to production efficiency, their revenue-yielding advantages outweigh their regressive incidence.

(B) If, used in conjunction with more rigorous monetary measures to keep down prices, the combination of Government retrenchment on civil expenditures and selective anti-inflationary taxation fails to yield enough to offset the mounting outlays for exigent military requirements, the balance must be found from borrowing.

The Government can in two principal ways foster real savings—and obtain thence, if necessary, the means of paying for part of the rearmament cost. The first is by offering the inducement of an attractive rate of interest. In an emergency like the present, voluntary savings thus induced would be "cheap at double the price" now offered. The second method is by vigorous campaign to encourage systematic saving habits and regular investment in Government bonds. To this end, the device previously suggested, of providing for deduction in certain circumstances of United States savings bonds purchases from taxable income, should contribute powerfully. Another device working toward the same end might well be tried, namely one assuring purchasers of a special series of savings bonds that their frugality would not be in vain. Guaranteed that, "come what may," the investor in a savings bond, series —, would be entitled at maturity to a fund of purchasing power equivalent to that foregone in purchasing the bond, there is little doubt that the volume of voluntary savings in this country would mount to a level more than adequate to meet the Government's financial needs in the present, or any foreseeable, emergency. Preventing inflation would then be no problem at all.

The objection has been raised that offering a "purchasing power" bond would lead to a flood of conversions of present issues, and of transfers of funds from existing nongovernmental obligations, into such a series. But restriction of such an issue to individual purchasers and limitation of holdings, similar to, but if need be lower than, the limitation now in force with respect to United States savings bonds, should suffice to forestall the apprehended "stampede" of funds thereto.

In conclusion, without attempting to summarize the analysis, four features deserve emphasis. First, the danger of further inflation is real—an ominous menace to the abiding interest of every class in the community. Second, the source of inflation is an excessive supply of money relative to the available supply of goods and services, and not, as frequently contended, excessive income payments. Rising wages and profits are signals, not causes, of inflation. Third, efficacious means of preventing further inflation are available, but responsibility for invoking them lies on the Government. Spontaneous, sporadic, self-selected measures for meeting the inflationary peril are likely to cancel out, if indeed they do not aggravate the crisis through degenerating into a sauve qui peut scramble. Fourth, the paramount need is to release from civilian production the men, machines, and materials required for executing the defense program. The fairest, surest, and most economical way to accomplish this is through a blend of governmental economizing, heavier taxation, and vigorous stimulation of savings. Pursued resolutely and firmly, yet without forgetting the virtue of moderation in all things and above all in fiscal affairs, these polices would enable us to avoid the economic quicksands of inflation.

Sincerely yours,

MYRON W. WATKINS.

URBANA WINE CO., INC.,
Urbana, Hammondsport, N. Y., August 6, 1951.

Hon. W. F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR MR. GEORGE: We follow with great interest the tax hearings; the way they are conducted is a credit to you and your committee and the best protection our people have against unwise and unfair tax proposals.

The American wine industry has always been ready to accept its share of the tax burden, and in return it expects fairness in its distribution.

It is for that reason that we respectfully remind you that the greatest part of the present excise taxes on wines are special war taxes; they were considered as very heavy and exceptional, they were voted as temporary measures, to be repealed at the end of the war. Now, not only have they not been repealed for the last 4 years, but it is proposed to increase them again.

There is another side to the question, an important moral side. Every informed citizen knows all the evils generated by prohibition. Outrageous taxes on alcohol bring the same result. One of the best ways to fight alchoholism in this country is to favor temperate drinking of table wines with meals against heavy liquor drinking before meals. Any additional taxation on wines now would be a terrific blow to temperance and a great victory for the bootleggers and producers of moonshine alcohol.

I also wish to bring to your attention the terrible injustice of the champagne tax. If the American Government had desired to destroy the champagne industry, it would have not acted in any different way.

The American champagne production has always had to compete with French champagnes made at a lower cost and with cheaper labor, while it has slowly been recovering from the blows dealt by prohibition. The Government has given tremendous help and protection to all other agricultural industries in similar circumstances; what has it done for the Amercina champagne industry?

Since repeal of prohibition it has raised the tax per case first from $1.20 to $1.44 and then to $7.20 during the war. During the same period of time, it has reduced the import duty per case of French champagne first from $14.40 to $7.20 and then lately down to $3.60.

Can any industry in the United States claim such unfair treatment? If so, I would like to know it.

Champagne is the only wine not taxed on the alcohol content. It is supposed to be a luxury beverage because it sparkles. Then why not heavily tax sparkling water because of the luxury of its bubbles? And why should a bottle of champagne at $3.90 a fifth be taxed as a luxury when a bottle of old French still Burgundy at $5 a fifth is not?

Champagne is a dry wine and a temperate drink and it should be taxed at the rate of the dry wine tax.

The dollar receipts from the champagne tax is extremely small compared with the balance of the wine industry tax receipts. An extremely small increase in the wine tax would easily compensate the loss of revenue from the repeal of the frightful and unjust champagne tax.

As this tax is added to the price of a champagne case when it leaves the winery, it is included in the price charged to the wholesaler. After the 25 percent mark-up price of the wholesaler and the 50 percent mark-up of the retailer, the increase in the price of champagne to the consumer due to the tax is $14.40 per case or one third of the retail price.

I am sure that your committee will study these facts carefully and take appropriate action.

Yours very truly,

URBANA WINE CO., INC.
CHARLES M. FOURNIER,
President.

Senator KERR. We will now recess until 10 o'clock tomorrow morning.

(Whereupon, at 1:15 p. m. the committee recessed to reconvene at 10 o'clock a. m., Tuesday, July 31, 1951.)

REVENUE ACT OF 1951

TUESDAY, JULY 31, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd, Hoey, Kerr, Taft, Martin, and Williams.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. The committee will come to order.

Mr. John Canelli.

STATEMENT OF JOHN CANELLI, PRESIDENT, NATIONAL BOWLING COUNCIL

Mr. CANELLI. Good morning, Senator Byrd. Mr. Chairman, we are aware of the work that you have to do. Can we have permission to file our formal brief with the reporter? We will be glad to do so and waive our time for oral presentation.

Senator BYRD. Thank you.

Mr. CANELLI. It has already been filed for your benefit. May I give you and the other members a synopsis of our brief which will help you in understanding it?

Senator BYRD. Yes.

Mr. CANELLI. Thank you.

(The prepared statement referred to follows:)

STATEMENT OF JOHN CANELLI, PRESIDENT, NATIONAL BOWLING COUNCIL, WASHINGTON, D. C.

My name is John Canelli. I am from Toledo, Ohio. I am president of the National Bowling Council, and also president of the American Bowling Congress.

The National Bowling Council is composed of representatives of all of the various bowling groups of the country: The American Bowling Congress, the Woman's International Bowling Congress, the National Duck Pin Bowling Congress, the Allied Candle Pin and Rubberband Pin Associations, etc., representing some 16 million bowlers.

We object to and oppose the proposal of the Secretary of the Treasury, Mr. John W. Snyder, for a 20-percent tax per game on the use of bowling alleys and billiard and pool tables in connection with the enactment of H. R. 4473 known as the Revenue Act of 1951.

Our objections, and the reasoning therefor which follows, were presented to the Committee on Ways and Means of the House, which, after due and thorough consideration, believed our reasoning to be sound and valid, and substituted for the proposed 20-percent tax per game an annual tax increase of $5 per unit to be added to the present annual tax of $20 per alley bed and billiard and pool table.

We object to and oppose the proposed 20 percent tax per game on the use of bowling alleys, billiard and pool tables, the imposition of which would be an outright tax on these 16,000,000 bowlers on what has long been recognized as their necessary physical recreation activities. The proposed tax is the difference between taxing the participant in a recreation or sport instead of taxing the spectator who is being entertained or amused. The proposed tax would also bring about a drastic curtailment in the operation of the facilities needed to be maintained in order that these millions of our citizens can continue to participate in their favorite and beneficial recreation.

Bowling is not a luxury, nor can this proposed tax be in any manner construed as a tax on a luxury article. Bowling is not an amusement. It is a participant recreation, providing valuable and necessary physical recreation for these millions of Americans, and is a valuable part of the employee recreation program of some 20,000 industrial plants, large and small, throughout the Nation. I also wish to add, that 15 percent of the membership of the American Bowling Congress is made up of church and Sunday school leagues, and here in Washington more than 4,000 bowlers from the duckpin group are from the various churches.

Bowling is the poor man's recreation. The income chart submitted by the Secretary of the Treasury, Mr. Snyder, shows that 83 percent of the taxpayers of the country earn less than $5,000 per year. A few years ago the United States Department of Commerce issued a report showing that 77 percent of the wage earners of the country were in the less than $3,000 per year salary bracket. In relative values of today's salary levels and cost of living we are certain that the same percentage still holds. A very careful survey by the national bowling organizations shows that 75 percent of the bowling participants come from these low-income brackets and, as such, are least able to pay the proposed tax.

The proposed tax is discriminatory and grossly unfair, in that it is an unprecedented tax on the participants in a particular recreation and sport. Bowling is one of the greatest, if not the greatest, of participant recreations, and the participants come mostly, as already stated, from the lower income groups with strictly limited amounts of money to spend for recreation. In fact, it is the only sport available to millions who, because of some physical disability, advanced age, or other causes, are unable to take in any other participating recreational sport. It is obvious what will happen if the cost of bowling is increased 20 percent by the addition of the proposed tax. A large number of the bowlers of the Nation, already faced with the burden of increased costs of living and the problem of making both ends meet, will undoubtedly be forced to give up participation entirely. And the majority of the rest will be compelled to curtail their only regular form of exercise and recreation.

As a logical result of this a further, and probably more serious effect of such a tax would be its effect on the average bowling establishment owner. We conscientiously tell you that the imposition of this tax would force thousands of bowling establishments to close. Bowling participation has already sharply declined during the past several years, approximately 20 percent in the past year, due to only one reason—insufficient funds on the part of the participant, occasioned by the continued rise in the cost of living further reducing the amount of money left over from the pay check for recreation and other purposes. This statement of fact of the decline in bowling participation, only too well known to us and the ten thousand-odd bowling proprietors of the Nation, represents a fact that is substantiated by the Secretary of the Treasury's own figure.

By that I mean this: In 1948, when a similar tax of 20 percent was proposed on the cost of bowling, the estimated revenue to be raised by such a tax was listed in the bill then before your committee as $27,000,000. The Secretary of the Treasury now estimates that the selfsame 20-percent tax would bring in a revenue of only $20,000,000, admitting a decline of more than 25 percent in bowling participation. It is also only too well known to us that during the past year bowling establishment after establishment has been striving to keep its doors open hoping for better days. A further reduction in the purchasing power of the participant by the imposition of a 20-percent tax would so reduce participation in bowling that it is certain several thousand establishments would be forced to close, thereby causing both the entire loss of the capital investment of the owner as well as the present means of livelihood. As about 70 percent of the bowling establishments are located in the smaller towns and rural communities, this would deprive a large number of these communities of necessary recreation facilities.

When the proposed 20-percent tax on bowling was before the Congress in 1943, President Truman, then a Member of the Senate, wrote the following, under date of December 1, 1943, to the president of the Bowling Proprietors Association of America, saying: "I agree with you that such a tax would be highly discriminatory against one of our most popular and beneficial recreations and would probably result in many bowling establishments going out of business. It would be an injustice to both proprietors and participants of the game." As far as the statement of Mr. Truman is concerned, definitely the conditions which prompted him to say this in 1943 are not anything but worse, as is proved by the figures of the Secretary of the Treasury in 1943 and those of the present Secretary, which bluntly admit a 25-percent decrease in the volume of business.

In 1943 the Treasury, in connection with a similar 20 percent tax proposal estimated the tax revenue at $27,000,000 for bowling and billiards. Billiards, however, was to be subject to a $20 per table tax, which would result in a revenue of about $2,000,000. It follows that the estimated tax revenue in 1943 for bowling alone was expected to be $2,000,000, thereby indicating a gross volume of business of $125,000,000. In 1951 the Secretary of the Treasury's estimate is $20,000,000 tax income for bowling and billiards combined. Since billiards accounts for about one-third of the total, the Treasury expects about $13,000,000 from bowling, thereby indicating a $65,000,000 gross volume of business for bowling. Despite more bowling alleys in existence than in 1943, the Treasury expects the volume of business to be about one-half of what it was in 1943 (which apparently was arrived at after taking into account the anticipated drop the imposition of this tax would cause).

One would be hard put to it to think of a business that could continue with a 50-percent reduction in its volume. Especially is this so with a business all of whose expenses and charges are fixed and not variable with a decrease in volume of business. That is exactly the kind of business bowling is, with the net result that most establishments, already operating perilously close to the area of red-ink figures, will have to close. In addition to our concern over the serious impact the proposed 20-percent tax will have on the millions of bowlers in drastically curtailing their recreational activities, a further concern here is to see that the bowlers are not deprived of places to bowl by these bowling establishments being forced to close.

May I also point out to the committee that, at present, the Government is collecting $20 tax per bowling lane and billiard and pool table per year, and that there will be no collectible tax at all from the establishments that are forced to close.

May I review the history of this same proposed 20-percent tax on bowling and billiards. Our groups were very negligent back in 1943 when a similar proposal was up for hearing. In our negligence we failed to supply the Committee on Ways and Means of the House with adequate information and the House voted in favor of the tax.

When, later, we did give a more adequate story to the Senate Committee on Finance the 20-percent tax aspect was removed from the bill. The Senate committee voted unanimously against it. Chairman Walter F. George, reporting out the bill, making the following comment: "The House bill shifted the tax on bowling alleys from a flat $10 per alley to 20 percent of the charge. * * * This shift appeared to be unduly burdensome for a participant sport, such as bowling. Further, the tax on a per-game basis would require a great deal of bookkeeping and auditing that would not be required on a flat tax per alley. Hence, your committtee set the bowling alley tax at $20 per alley." and when the matter was referred to the conferees of the House and Senate the House Members accepted the Senate version, with the result that the 20 percent tax on bowling was eliminated entirely, and the $10 per alley bed tax was increased to the now existing $20 per bed levy.

Any tax law must be fair and serve some useful purpose not outweighed by the damage it will do. This tax proposal is unsound and will not serve a useful purpose commensurate with the damage it will do. First, the proposed 20-percent tax on bowling will not stop any inflationary impetus in that the money proposed to be taxed has not caused any inflation in the past, and will not reach any future spending tending to an inflationary impetus, since bowling spent money is not luxury-spent money, but money spent on a necessary and essential participant recreation and sport. Second, and to the contrary, this tax will impede and restrict a necessary recreation pursuit of millions of our citizens, with an anticipated but purely conjectural revenue of $20,000,000 only and if the same volume of bowling continues as anticipated by the Treasury Department, and if all presently operating bowling establishments, billiard rooms, and so forth, are able to remain in business. Isn't it reasonable and sound to expect that, with 20 cents being taken out of the bowling participant's dollar for tax, that he must, of necessity, have 20 cents less from each dollar to spend for bowling which, translated into cold facts, means a further reduction of 20 percent in bowling participation for the proprietor. In the time that has elapsed since the proposal of this tax we have heard from approximately 1,000 proprietors, from every State in the Union, 75 percent of whom have said they would be forced to close if the tax is put into effect.

We submit to the committee that the harm and damage to be done by the imposition of this tax would in no way be compensated for by the amount of good that could be done with such a comparative small amount of money, even if you got it. We respectfully and earnestly urge that the proposed 20 percent tax on bowling, billiards, and pool, as recommended by the Secretary of the Treasury, Mr. Snyder, be rejected and we feel that in the best interests of the important and needed recreation programs for the citizens of our country, in which bowling plays an important and major part, the tax on bowling, billiards, and pool should remain at $20 annually per bowling alley, billiard, and pool table.

Senator BYRD. Mr. Earl E. Raymond?

STATEMENT OF EARL E. RAYMOND, CHAIRMAN, WASHINGTON ACTIVITIES COMMITTEE, TRAILER COACH MANUFACTURING ASSOCIATION AND TRAILER COACH ASSOCIATION (WEST COAST)

Mr. RAYMOND. Mr. Chairman, I have a prepared statement and I will take less than 10 minutes.

May I read it?

Senator BYRD. Yes, go ahead, Mr. Raymond.

Mr. RAYMOND. Mr. Chairman and gentlemen of the committee, my name is Earl Raymond. I am a trailer-coach manufacturer from Saginaw, Mich., and am chairman of the Washington Activities Committee representing the Trailer Coach Manufacturers Association, 20 North Wacker Drive, Chicago, Ill., and the Trailer Coach Association of the West Coast, located in Los Angeles, Calif. These two associations represent approximately 85 percent of the production of the industry.

Our industry is appearing before you today to ask that trailer coaches, which are in reality mobile homes, be exempted from the Federal excise tax.

Since 1941 our product has faced an excise tax of 7 percent. The revenue act of that year uses the word "trailer" in section 3403 (subsec. B) of the Internal Revenue Code. That section pertains to the excise tax imposed upon automobiles and related vehicles.

At the time the act was passed in 1941 there was no question but that a considerable percentage of our production was used for travel and vacation activities.

However, since 1941, the character of the trailer-coach business has changed radically. More and more—and the trend has been accelerated in recent years—trailer coaches have come to be used as mobile homes, used the year round and moved from place to place as circumstances dictate.

A recently completed survey made by Trailer Finance Associates of Grand Rapids, Mich., a leading national trailer coach banking group, showed that about 93 percent of the trailer coaches sold today are used as mobile housing. About 68 percent of the trailers are used by defense workers and approximately 25 percent by military personnel and their families. Of the remaining 7 percent only about 1 percent is used for vacationists, or tourists.

The Trailer Coach Association of the West Coast has made a similar survey and reports almost identical percentages of use.

Added proof that trailer coaches today are being used as mobile homes is found in the type of unit we are constructing. We are following the demands of the customers. So far in 1951, 69 percent of the coaches constructed have been 30 feet, or longer, as compared to only 17 percent in that bracket in 1948. In 1948, 29 percent of those constructed were coaches of 23 feet, or shorter, while that size group has dwindled to 2 percent today.

All coaches constructed today are complete mobile living units equipped with modern kitchens, complete bathroom facilities, and furniture.

The type of coach manufactured when the excise tax was first imposed did not have all this modern equipment.

For illustrations of the modern mobile home trailer coach, I refer you to the attached booklet entitled "Mobile Housing for National Defense."

Since World War II many Government agencies, as well as congressional committees, have recognized and classified trailer coaches as mobile homes. The National Security Resources Board, vitally interested in the defense of our country, made a complete survey of defense housing needs of the Nation. This was done under the supervision of Mr. Ralph Kaul, who, at that time, was Acting Director of the Housing and Community Facilities Division of NSRB. Mr. Kaul is now chairman of the Critical Areas Committee of the Defense Production Administration.

In Mr. Kaul's final report to the NSRB, trailer coaches were definitely classified by him as mobile homes and as a vital and indispensable segment of any emergency housing program.

The Bureau of Standards in the Department of Commerce is currently developing plumbing standards for trailer coaches similar to those applied to permanent type houses.

The United States Public Health Service is developing suggested regulations for the establishment of trailer parking facilities as part of the development of mobile housing.

The Atomic Energy Commission is finding mobile housing a solution to some of its current problems. At its request, since January, our group has had a field staff working closely with the Atomic Energy Commission, the contractor, and State and municipal authorities in planning and developing proper trailer parking facilities for construction workers on the projects in South Carolina and Kentucky.

Recognition for this work has come from Dean Snyder, Deputy Commissioner for Special Services of the Federal Security Agency. Mr. Snyder states in a letter dated May 4, 1951:

> Your organization deserves great credit for the constructive work that you are doing in the Savannah River and Paducah areas.

Just as important, I believe, is recognition by Members of Congress. The Senate Preparedness Subcommittee, of which Senator Lyndon B. Johnson is chairman, in a report on July 19, 1951, recommended that the Department of Defense should—

> immediately initiate, to the fullest extent of its powers and resources, measures to alleviate housing conditions described in this report including:
>
> * * * * * * *

C. The utilization of any vacant or unused property for trailer camps.

That report dwelt on the deplorable housing conditions to which many servicemen and their families are subjected.

The report clearly indicates that trailer coaches, where good trailer parks are available, are a satisfactory answer to the conditions described in the report. In this connection, I have already quoted the recommendation with regard to the utilization of unused space on military reservations for trailer parks.

The report also mentions some substandard trailer parks on private property and justly criticizes them. But the same report clearly indicates that trailer coaches, where good trailer parks are available, are a satisfactory answer to the conditions described therein.

Secretary of the Army Frank Pace, Jr., immediately took cognizance of the report and wrote a letter to Senator Johnson in which he said:

I have directed the commanders of our installations to immediately study the feasibility of using any vacant or unused property for trailer camps.

The very tax bill you are considering recognizes the differences between mobile housing and the automobile industry. The House of Representatives voted to increase the automotive excise tax from 7 to 10 percent but voted to hold the tax on trailer coaches at 7 percent. If the House had not recognized the difference, the tax on trailers also would have been increased.

We feel that the House should have gone further and should have removed the tax on trailer coaches completely. There is no other way than removal of the tax to be fair to the servicemen and defense workers who are using trailers as homes—and almost all trailers sold today are being used as homes. We would like to point out that no excise tax is placed on ordinary type homes, whether luxury type or even vacation cottages. Yet, a burdensome and inequitable tax is placed on those who seek to meet the housing emergency through the use of trailer coaches.

A mistake with regard to trailers during World War II has been corrected. During the war WPB classified our product, so far as material allocation was concerned, in the automotive divisio...

There is no question that such a classification was an error since the automotive division had little to do with housing and the Government during World War II prohibited the manufacture of trailer coaches, except for housing for Government use. A lot of confusion resulted.

Today, trailer coaches are properly classified in the Building Material Division of NPA, and we have been granted specific allocations of critical materials under CMP for mobile housing purposes.

We are not at this time questioning the original action which classified us as an automotive industry but we do feel that an error has been committed in keeping the excise tax on trailer coaches, and we appeal to you to correct that mistake.

The Senate recognized the trailer coach as housing when it passed its defense housing bill, by stating that wherever the words "prefabricated house" are used they shall also apply to "mobile housing." Why then should the prefabricated house be free from a Federal excise tax and the mobile house be taxed when both are "housing"?

Many persons are under the impression that the trailer coach is not taxed other than the Federal excise tax. This presupposes that the trailer coach vanishes after it is purchased.

We would like to point out that virtually all trailer coaches pay a highway vehicle tax; many must pay a personal property tax; some States and municipalities impose a special trailer tax; and almost all trailers are taxed through taxes imposed on trailer parks, either as improved property, or as levies on each trailer site reflected in rentals.

As an association, we want trailers to pay their fair share of State and community taxes, and feel that, in most instances, they are paying taxes commensurate with other housing now. However, this is a State and local problem and has nothing to do with a Federal excise tax which is placed on one type of housing and not on other types.

Not only does discriminatory taxation on trailer coaches affect the individual purchaser but it affects the ability of industry to help solve the defense housing problem.

In the Savannah River area the du Pont Corp., charged with constructing the atomic energy plant there, has requested bids on a vast housing project specifying trailer coaches, or small portable or prefabricated houses. We feel that trailer coaches are the answer to the fundamental housing problem at Aiken. But this discriminatory tax puts the trailer coach manufacturer at a tremendous competitive disadvantage.

There is currently discussion about emergency housing problems in Kansas City, Kans., an area devasted by floods? Some prefabricated house manufacturers have made claims that they can offer housing at a lower cost than trailer coaches. Whether their claims are correct or not is not to be discussed here but my point is that again the trailer coach industry must consider the tax burden before it can even enter bids, if bids are asked for. If the unfortunate flood-stricken families desire to purchase individual mobile housing direct—they again must pay a tax for that privilege.

In view of recognition as mobile housing by the various agencies of the Government, and in view of the fact that evidence shows trailer coaches today are being used as mobile homes, we respectfully submit that the Federal excise tax on trailer coaches should be repealed. The simplest way to remove this discrimination is to amend section 3403 (b) by adding the words "trailer coaches" after the words "except tractors" in said paragraph.

Senator BYRD. Thank you very much.

Mr. RAYMOND. Thank you.

Senator BYRD. In lieu of an appearance the Chair inserts the statement of the Trailercoach Dealers National Association at this point.

STATEMENT OF JOHN C. WILLIAMSON, WASHINGTON COUNSEL, TRAILERCOACH DEALERS NATIONAL ASSOCIATION

Mr. Chairman and members of the committee, I am grateful for this opportunity to testify in behalf of the Trailercoach Dealers National Association in opposition to the retention in the pending tax bill, H. R. 4473, of the excise tax on mobile housing.

I would first like to state that the present 7 percent excise tax on trailercoaches, or mobile housing, which the present bill would continue, came about more as a result of a misapplication of the law than by the specific intent of the Congress. The reason is quite obvious. In the 1941 Revenue Act (sec. 3403 (b)) an excise tax of 7 percent was imposed on trailercoaches because of their affinity to the automobile—because, to employ the language of the statute, they were "suitable for use in connection with passenger automobiles." Since 1941, however, experience has proven that the relationship of the trailercoach to the automobile is only incidental, and that there is a much closer and more clearly defined affinity of the trailercoach to a family dwelling unit. Trailercoaches have become mobile housing and the automobile serves only, what has proven to be, the infrequent application of the unit's mobile characteristic.

The best evidence of the need for a general reorientation in the public as well as congressional approach to the trailercoach as a taxable commodity is the fact that over 93 percent of the house-trailer units sold during the past several years are used as family dwelling units and for all practical purposes are permanent on-site housing. We submit therefore that the present excise tax which singles out house trailers as the only housing subject to an excise tax is unwarranted, discriminatory, and, therefore, in violation of a most fundamental precept of our revenue system.

The experience of our industry during the past several years reveals that the owner-occupants of trailercoaches in the thousands of trailer parks throughout the country are assuming more and more the burden of local taxes for the support of local government and community services; and that these taxes compare most favorably with those levied against conventional housing. In many instances the owner of a $4,000 trailercoach pays more in local taxes (including licensing fees, etc.) than the owner of a conventional house with the same assessment value.

The 7-percent excise tax, therefore, becomes an added burden to the trailercoach owner, giving rise to an injustice which this committee and the Congress should and ought to remedy once and for all in this 1951 tax bill.

Several things have occurred in the past year which serve to emphasize the housing characteristic of the trailercoach as distinguished from the so-called automotive characteristic, the primary basis on which rests the present 7-percent excise tax.

Three months ago the Senate passed the bill S. 349, the defense-housing bill which authorizes the Housing and Finance Agency to acquire mobile housing units for defense workers to defense areas, and also authorizes direct loans to facilitate the manufacture and distribution of mobile housing in order to enhance the defense housing effort. The above two provisions of this housing legislation also relate to prefabricated housing which is not subject to the excise tax. Doesn't this rather point up the injustice of continuing to impose the burden of an excise tax on a mobile housing unit?

Again, on July 10, 1951, the Senate Preparedness Subcommittee issued a report on the deplorable housing situation to which our servicemen are subjected around military installations. The subcommittee noted that the use of trailercoaches and trailer parks, both on and off military reservations, were assuming a prominent role in meeting the temporary need for decent housing of servicemen and their families; and the subcommittee recommended that the Department of Defense take early steps to expend trailer park facilities in and around military installations to accommodate more mobile housing.

The present excise-tax increases by 7 percent the cost of such housing to these same servicemen.

We hope that we have been successful in bringing about a new approach to the question of taxing mobile housing. We are not here as advocates of a special tax-exempt status for our industry; rather are we here as pleaders for a more sound classification of the trailercoach as a taxable item. If the Congress in its wisdom decrees the taxation of housing units, whether they be conventional, prefabricated, demountable, portable, or mobile, then the mobile housing industry would be the last to contend that its burden was unjust.

However, in this instance mobile housing has been singled out for special tax treatment, singled out as something other than housing when in truth and in fact it is housing.

We ask, therefore, that the committee eliminate the present 7-percent excise tax as it affects mobile housing by amending section 3403 (b) by adding after the words "except tractors" in such subsection the words "trailercoaches designed for use as housing."

Senator BYRD. Mr. Bollum, President of the American Transit Association.

STATEMENT OF H. L. BOLLUM, PRESIDENT, AMERICAN TRANSIT ASSOCIATION

Mr. BOLLUM. I am H. L. Bollum, president of the American Transit Association, 292 Madison Avenue, New York.

Mr. Chairman and members of the committee, I am president of the Springfield Street Railway Co. which furnishes local transit service in Springfield, Mass., and vicinity.

I am appearing here before you today as president of the American Transit Association of 292 Madison Avenue, New York, N. Y., to express the views of the members of the association with respect to the taxes proposed in H. R. 4473.

We are particularly concerned about the effect of those providing for increased manufacturers' taxes on new business and on automotive parts and accessories used in busses; an increased tax on gasoline and liquefied petroleum gases, and in imposition of taxes on fuel used in Diesel-propelled power highway vehicles.

These additional excise taxes would add about $6 million to the industry's already heavy tax burden.

The members of your committee have been furnished with copies of a statement setting out fully the position of the members of the American Transit Association with respect to specific taxes mentioned above and, I understand that this complete statement will be made a part of the record of these hearings and will be given the same consideration as though presented here at this time.

However, on account of the 10-minute time limitation which I have been asked to observe, I will present at this time only a brief statement identifying the industry which I represent, and the summary and conclusions found on pages 4 and 5 of our complete statement.

The American Transit Association is a voluntary trade association whose member companies transport over 80 percent of the more than 17 billion persons using local transit facilities in the United States each year.

These companies operate in cities and towns of various sizes throughout the United States, including the major cities. The operations of most transit companies are confined to city streets and these streets are generally not part of our State-aid highway system.

Thirty-five of the approximately one thousand, four-hundred transit systems operating in the United States are publicly owned and operated, including those systems which serve some of our major cities, such as, New York, Chicago, Detroit, Cleveland, Boston, San Francisco, and Seattle.

These publicly owned and operated systems are exempted from the payment of the present proposed and the present existing excise taxes as stated above.

Summary: We vigorously oppose the imposition of additional taxes on gasoline and liquid peroleum gases, busses and bus parts, or accessories, as well as the proposed new tax on Diesel fuel, since all are obviously special taxes designed to increase general revenues, yet are limited in their application, and are thus discriminatory.

In addition, we firmly believe that the transit industry is entitled to complete exemption, or a substantial measure of relief from even the present Federal tax on gasoline and liquefied gases and from the manufacturers' excise taxes on busses and their parts or accessories for the following reasons:

1. Transit operations, unlike those of most other highway users, are almost exclusively confined to those city streets which are largely built and maintain with municipal funds, although State funds may be used, in part, to build or maintain a limited number of such streets which comprise extensions of through routes.

2. Transit operators, unlike most other highway users, pay substantial amounts in the form of franchise fees and other imposts into the municipal funds used for street purposes, and, in addition, like other highway users, make substantial tax payments to the States for general highway purposes.

3. Transit service is not in the luxury category but is essential to the business and social life of a community in normal times and is generally recognized as being one of the most important defense-supporting industries in an emergency.

4. Transit is the poor man's transportation and any tax imposed upon it becomes a burden on the lower-income groups.

5. Appendix B shows the depressed financial position of the industry which makes it necessary for transit companies to endeavor to pass taxes, as well as all other costs, on to the transit rider in the form of higher fares; while appendix A shows the continuing decline in transit riding since VJ-day, which is indicative of rider resistance to higher fares.

Finally, we urge that any future taxes levied on gasoline, liquefied petroleum gases, or Diesel fuel be made applicable to all users of such fuel in order that the necessary revenue can be produced by applying the smallest possible tax rate per gallon to the widest possible base. We also urge that the same principle be applied with respect to any future taxes on busses or their parts and accessories by imposing similar taxes on a great variety of other products or services which are no more essential to the defense effort than the service furnished by transit companies. We believe that past history also makes it imperative that any legislation passed at this time to increase the present level of taxes, or to impose new taxes, should contain specific provisions for their automatic termination when the emergency which gives rise to them has ceased to exist.

Senator BYRD. Thank you very much.

Mr. BOLLUM. Thank you very much, sir.

(The prepared statement referred to is as follows:)

STATEMENT OF H. L. BOLLUM

Mr. Chairman and members of the committee, my name is H. L. Bollum. I am president of the Sprinfield Street Railway Co., which furnishes local transit service in Springfield, Mass., and vicinity. I appear before you today as president of the American Transit Association of 202 Madison Avenue, New York 17, N. Y., to express the views of members of the association with respect to some of the taxes proposed in H. R. 4473, particularly those providing for increased manufacturers' excise taxes on new busses and on automotive parts or accessories used in busses; an increased tax on gasoline and the imposition of a tax on fuel used in Diesel-powered highway vehicles. These additional excise taxes would add about $6,000,000 to the industry's present heavy tax burden.

The American Transit Association is a voluntary trade association whose operating member companies transport over 80 percent of the more than 17 billion persons using local transit facilities in the United States each year. These companies operate in cities and towns of various sizes throughout the United States, including the major cities. The operations of most transit companies are confined to city streets and these streets are generally not part of our State-aid highway system. Thirty-five of the approximately one thousand four hundred transit systems operating in the United States are publicly owned and operated, including those systems which serve some of our major cities, such as New York, Chicago, Detroit, Cleveland, Boston, San Francisco, and Seattle.

The local transit industry is essential to the business and social life of communities in normal times and in times of emergency is generally recognized as one of the most important defense-supporting industries.

Since the latter part of 1946 the transit industry has suffered a substantial and continuing decline in the volume of its business. This is clearly shown on the chart, appendix A. At the same time, the industry's operating expenses have risen steadily and very substantially. The combined effect of these two trends is a sharp reduction in the industry's earnings and in the rate of return on the money invested in the business, despite the fact that nearly all transit companies have increased their fares one or more times since 1946. As indicated in the table, appendix B, it is estimated the industry earned less than 1½ percent on its investment in the year 1950.

These facts prove that it is necessary for the industry to endeavor to pass any additional costs on to the riding public and are indicative of the difficulty in doing so.

TAX ON GASOLINE AND LIQUID PETROLEUM GASES

Certainly gasoline and liquid petroleum gases used in furnishing transit service are not luxuries, yet transit and other commercial highway users have been a favorite target of public administrators seeking sources of additional tax revenues for the past 20 years. We join other highway users in supporting the proposition that each class of highway users should pay special fees and taxes sufficient to cover their fair share of the cost of building and maintaining our highway systems. However, we believe it to be inequitable to expect transit operators to pay into the general revenue funds of both the Federal and State Governments the same special taxes paid by other highway users since transit operations are largely confined to city streets which, in all States are largely, if not entirely, constructed and maintained with municipal funds to which transit operators also make substantial payments in the form of special taxes or fees. The State of Michigan recognized the soundness of this principle recently by exempting transit companies from the payment of higher gasoline taxes and from certain other levies.

Since highway users generally paid special highway taxes to State and Federal governments in 1949 which were almost double the total expenditures on State-administered highways, the proposed taxes on gasoline, liquid petroleum gases, and Diesel fuels, new vehicles and their parts or accessories, cannot be justified except as a general revenue measure and, as such, are discriminatory. The total special tax payments by the transit industry in the form of State and Federal fuel taxes, franchise taxes, license fees, and manufacturers' excise taxes on new vehicles and parts or accessories are estimated to be about 9 to 10 percent of its total revenues.

It should be noted that publicly owned and operated transit systems are exempt from the payment of all such taxes, and while such systems generally do not compete with privately owned and operated transit systems, such competition does exist to a degree in our two largest cities. In addition, these tax-exempt systems generally set the pace for privately operated systems in the matter of wages and working conditions, a problem of considerable importance in view of the fact that direct wage costs in the transit industry represent almost 60 percent of gross revenues.

The report of the House Ways and Means Committee on H. R. 4473 refers to the fact that a reduction in the present tax on domestic telegraph service is justified on the basis that the industry is in a depressed financial condition and is essential to the civilian economy and to national security. The table attached hereto as appendix B shows clearly the depressed financial condition of the transit industry. We submit that transit service is also likewise essential to the civilian economy and to national security, and we believe its declining financial position provides equal justification for the granting of relief from even the present Federal tax of 1½ cents per gallon on gasoline and liquid petroleum gases.

H. R. 4473 proposes the repeal of the present tax on electric energy consumed by residential and commercial users. The report of the House Ways and Means Committee indicates that said repeal is proposed, in part, because it is believed to be one of the most burdensome excise taxes with respect to the lower-income groups. Any excise taxes levied on transit companies are also particularly burdensome to the lower income groups which generally must depend upon transit service for transportation to and from their jobs as well as for other travel by themselves and their families.

The decline in transit riding shown on appendix A is indicative of the difficulty of passing higher costs on to the riding public in the form of higher fares irrespective of whether they result from higher labor costs, higher material costs, or higher taxes. Therefore, we submit that there are as many sound reasons for repealing all of the present excise taxes which directly affect transit companies as there are for repealing the tax on electric energy.

The proposed increase of one-half cent per gallon on gasoline and liquid petroleum gases would add almost $1,500,000 to the already serious financial burden of privately operated transit companies struggling to maintain their place in our system of private enterprise.

TAX ON DIESEL FUEL

The proposed 2 cent per gallon tax on fuel used in Diesel-powered highway vehicles is obviously a special user tax since it would not apply to Diesel fuel used for any off-the-highway purpose such as industrial, commercial, or residential heating, railroad operation, and many other uses.

The report of the House Ways and Means Committee states that it is necessary to tax Diesel fuel in order to prevent discrimination against vehicles powered by gasoline. While the present law provides some measure of discrimination between vehicles using gasoline or liquid petroleum gases and those using Diesel fuel, it is even more discriminatory to tax only the Diesel fuel used for highway purposes while leaving Diesel fuel used for a variety of other no more essential purposes untaxed. This is especially true since the present and proposed tax on gasoline and liquid petroleum gases applies to such fuel used for the propulsion of motorboats or airplanes as well as motor vehicles, while the proposed tax on Diesel fuel applies only to that used in highway vehicles.

The transit industry, which now pays at least its fair share of special highway user taxes, urges that any Federal tax levied on gasoline, liquid petroleum gases, or Diesel fuel should apply irrespective of whether the fuel is used for highway or any other purposes. This, we submit, would be far more equitable and would require a much lower rate per gallon to produce the same aggregate amount for general revenue purposes.

The proposed tax of 2 cents per gallon on Diesel fuel would also increase the present serious financial burdens of privately operated companies by about $1,500,000 per year.

TAX ON NEW BUSES AND PARTS OR ACCESSORIES

The proposal to increase the present excise tax on new busses from 5 percent to 8 percent on the approximately 6,000 new busses which the industry buys each year to replace obsolete and worn-out vehicles would add more than $2,000,000 per year to the present heavy tax burden of privately operated companies. This is obviously another tax for general revenue purposes since it cannot be justified as a special user tax.

The report of the House Ways and Means Committee refers to this 60-percent increase in the present excise tax on new busses as a moderate increase and infers that it would be absorbed and not passed on to the transit rider. This proposal is not considered to be moderate by an industry in serious financial circumstances and whose present earnings force it to attempt to pass the resulting higher costs on to the transit riders by charging higher fares. This is particularly true in view of the other proposed taxes on fuels and parts or accessories. It is true that the proposed tax on new busses would remain less than the 10 percent tax on new automobiles, but the increase on busses would be 60 percent while that proposed for new automobiles is about 43 percent.

Excise taxes are generally levied only on those items in the so-called luxury category. We believe it to be highly discriminatory and inequitable to subject the local transit industry, "the poor man's transportation," to taxes not applicable to many other products or services of a less essential nature.

H. R. 4473 provides for a uniform increase of from 5 percent to 8 percent in the excise tax on automotive parts or accessories whether used in automobiles, busses, or trucks, since in many cases the parts or accessories are interchangeable. This change will add approximately $1,000,000 to the present heavy tax burden of privately operated transit companies. Like the tax on new vehicles, it is obviously a general revenue measure and is discriminatory. The report of the House Ways and Means Committee explains that the proposed tax on parts or accessories is lower than the proposed tax on new automobiles because the bulk of such parts or accessories is purchased by owners of old or second hand cars who are largely the lower income groups.

We submit that lower income groups which, in many cases, cannot afford an automobile and must depend exclusively on local transit, should also be given consideration by exempting parts or accessories used in busses from this tax. It may be contended that it is difficult to administer the tax if certain exemptions are provided. This, we believe, is not a very convincing argument since the new law proposes to continue the complete exemption from the tax of most automotive parts and accessories for all new or used farm equipment.

SUMMARY AND CONCLUSIONS

We vigorously oppose the imposition of additional taxes on gasoline and liquid petroleum gases, busses and bus parts or accessories, as well as the proposed new tax on Diesel fuel, since all are obviously special taxes designed to increase general revenues, yet are limited in their application and are thus discriminatory.

In addition, we firmly believe that the transit industry is entitled to complete exemption or a substantial measure of relief from even the present Federal tax on gasoline and liquid petroleum gases and from the manufacturers' excise taxes on busses and their parts or accessories for the following reasons:

1. Transit operations, unlike those of most other highway users, are almost exclusively confined to those city streets which are largely built and maintained with municipal funds, although State funds may be used, in part, to build or maintain a limited number of such streets which comprise extensions of through routes.

2. Transit operators, unlike most other highway users, pay substantial amounts in the form of franchise fees and other imposts into the municipal funds used for street purposes and, in addition, like other highway users, make substantial tax payments to the States for general highway purposes.

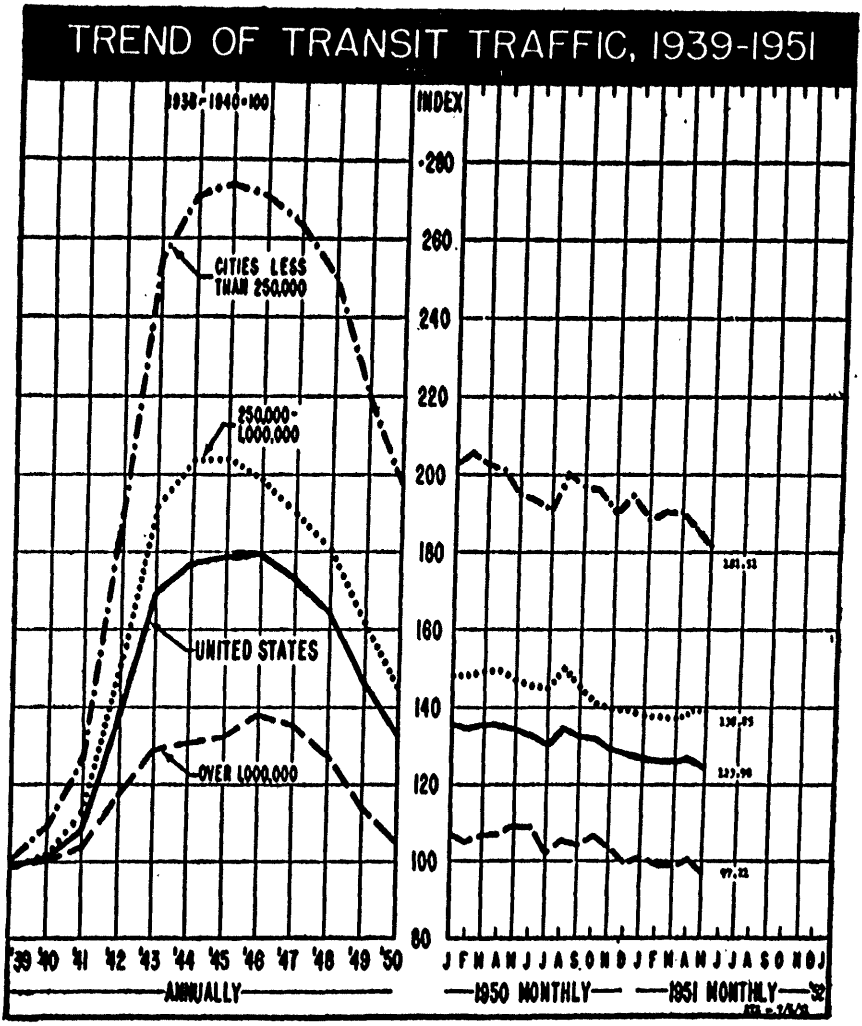
3. Transit service is not in the luxury category but is essential to the business and social life of a community in normal times and is generally recognized as being one of the most important defense-supporting industries in an emergency.

4. Transit is "the poor man's transportation" and any tax imposed upon it becomes a burden on the lower-income groups.

5. Appendix B shows the depressed financial position of the industry which makes it necessary for transit companies to endeavor to pass taxes, as well as all other costs, on to the transit rider in the form of higher fares, while appendix A shows the continuing decline in transit riding since VJ-day which is indicative of rider resistance to higher fares.

Finally, we urge that any future taxes levied on gasoline, liquid petroleum gases, or Diesel fuel be made applicable to all users of such fuel in order that the necessary revenue can be produced by applying the smallest possible tax rate per gallon to the widest possible base. We also urge that the same principle be applied with respect to any future taxes on busses or their parts and accessories by imposing similar taxes on a great variety of other products or services which are no more essential to the defense effort than the service furnished by transit companies. We believe that past history also makes it imperative that any legislation passed at this time to increase the present level of taxes, or to impose new taxes, should contain specific provisions for their automatic termination when the emergency which gives rise to them has ceased to exist.

APPENDIX A



American Transit Assn., 292 Madison Avenue, New York 17, N. Y.

APPENDIX B

Transit industry of the United States—Financial results of operations and return on investment, calendar years 1933 to 1950, inclusive

[000 omitted]

Year	Operating revenue	Expenses other than wages and salaries	Taxes	Balance from which wages, salaries, and return on investment must be paid	Wages and salaries	Return on investment	Investment	Rate of return, percent
1933	$642,400	$205,420	$47,370	$389,610	$297,000	$92,610	$5,093,000	1.82
1934	674,900	211,490	49,183	411,227	314,000	100,227	4,954,000	2.02
1935	681,400	213,930	50,458	417,012	321,000	96,012	4,675,000	2.05
1936	727,900	227,180	56,920	443,800	338,000	105,800	4,611,000	2.29
1937	733,500	232,680	63,504	437,316	356,000	81,316	4,521,000	1.80
1938	700,800	228,690	65,723	406,387	351,000	55,387	4,422,000	1.25
1939	720,700	230,600	67,499	422,601	356,000	66,601	4,343,000	1.53
1940	737,000	238,030	62,688	436,282	360,000	76,282	4,096,000	1.86
1941	800,300	258,260	66,803	475,237	386,000	89,237	4,152,000	2.15
1942	1,040,000	307,390	128,650	603,960	462,000	141,960	4,208,000	3.37
1943	1,294,000	378,970	186,340	728,690	554,000	174,690	4,259,000	4.10
1944	1,362,300	413,070	189,250	759,980	599,000	160,980	4,271,100	3.77
1945	1,380,400	435,140	164,530	780,730	632,000	148,730	4,262,400	3.49
1946	1,397,100	416,430	129,020	851,650	713,000	138,650	4,180,900	3.31
1947	1,390,800	448,740	104,940	837,120	790,000	47,120	4,077,300	1.16
1948	1,488,600	514,651	101,210	872,739	829,000	43,739	3,900,000	1.12
1949	1,490,900	497,327	88,908	904,665	841,000	63,665	3,940,000	1.62
1950 [1]	1,474,400	484,600	88,000	901,800	847,000	54,800	3,950,000	1.39

[1] Preliminary, subject to revision.

Senator BYRD. Our next witness is Mr. Idol.

STATEMENT OF EDGAR S. IDOL, GENERAL COUNSEL, AMERICAN TRUCKING ASSOCIATIONS, INC.

Mr. IDOL. Mr. Chairman and gentlemen of the committee, my name is Edgar S. Idol, and I am general counsel of the American Trucking Associations, Inc., the trade association of the trucking industry.

We represent a federation of State associations including as their members substantially all of the 19,000 for hire motor carriers of the country, and also the bulk of the local 300,000 for hire operators.

Our State associations also represent many thousands of private motor carriers. Our offices are at 1424 Sixteenth Street NW., Washington, D. C.

Mr. Chairman, the question of discrimination, and most of the other matters connected with excise taxation on gasoline, automobile and automotive equipment, and Diesel fuels have been covered by other witnesses very largely.

I will attempt to avoid repetition. There are only one or two points that I would like to bring out. I would like to have my statement filed as part of the record, but——

Senator BYRD. That will be done.

Mr. IDOL. I believe the question of discrimination has been pretty fully treated by other witnesses.

There is one point I would like to direct to your particular attention and that is the extent to which other levels of Government use taxes of this type for revenue measures.

During the last 6 months, 11 States have increased gasoline and Diesel fuels by amounts ranging from 1 to 2 cents a gallon, and 14

States have increased charges for the operation of commercial trucks, principally through increasing registration fees.

Our industry, as you would note from that, is faced by continuing increases in its tax costs, some of which are justified on the ground of highway use payment, but many of which are not.

I think at this time our Federal tax has absolutely no justification on that ground. Currently the Federal Government collects more than a billion dollars a year in special-use taxes more than it pays in aid of highway construction.

Senator BYRD. You mean that is the gasoline tax, the Diesel and fuel tax, and what else? You said that they collect over a billion dollars——

Mr. IDOL. The Federal Government collects over a billion dollars——

Senator BYRD. I say what are these other taxes?

Mr. IDOL. The gasoline and automotive tax—the gasoline and automotive excise taxes.

Senator KERR. And lubricating oil taxes?

Mr. IDOL. Yes, sir; correct. I have some figures in my statement on total collections for the year 1949.

Senator BYRD. I think the gasoline taxes are nearly returned in full to the States, are they not?

Mr. IDOL. Are almost what, sir?

Senator BYRD. Gasoline taxes are returned in full to the States?

Mr. IDOL. No; I do not believe so, sir. You have Federal aid payments of something in the neighborhood of a billion dollars annually.

Senator TAFT. Between five and six hundred million?

Mr. IDOL. And your total Federal tax collections in special highway uses are very substantially in excess of that amount.

Senator WILLIAMS. Do you have the figures on gasoline tax revenue?

Mr. IDOL. Not separated in this statement, sir, but I will be glad to furnish them.

Senator KERR. They are in the neighborhood of a half billion dollars.

Mr. IDOL. From the Federal collection?

Senator KERR. Yes.

Senator MARTIN. Why not just get the exact figures, and also what the Federal Government grants to the States for highway construction.

Mr. IDOL. I would be very happy to furnish that to you.

One other point which I would like to call to your attention, sir, is the fact that the House recommendation for a tax on Diesel fuel is so clearly discriminatory and particularly against the commercial truck operators, because of the fact that it is limited in its application to that which is used in highway equipment, and we can see no possible equitable ground for that action.

It appears to us that if it is desired to remove some type of commodity discrimination, the appropriate method of doing it would be to enact the same tax in effect which is applicable to gasoline, and make it applicable to all Diesel fuel sales.

We have one other thing on the subject of excise taxation, which I would like to bring to your attention. The Committee for Economic Development has made what we believe to be the best recommendation to this Congress for taxation that we have seen.

They include in that recommendation a statement that after this bill is passed, the Joint Committee on Internal Revenue Taxation initiate a study of Federal excise taxes with a view to rationalizing the structure at the earliest appropriate time.

We have been trying, Mr. Chairman, and gentlemen, for some time to persuade the Congress to eliminate what we conceive to be all of these discriminatory taxes against highway operations.

We do not expect you to take any such action here on this bill, because we do not think circumstances will permit a reduction of present excise taxes, but we do urge your consideration of the CED recommendation, and we add our hope that you will order a complete investigation of this excise-tax situation with a view to eliminating discrimination.

I should like to take whatever time I may have left, Mr. Chairman, for a very brief discussion of the excess-profits-tax situation as the House bill would revise it.

Senator BYRD. All right, sir.

Mr. IDOL. There are three points in the House bill which would particularly affect the industry. They are all indirect increases in the excess-profits tax.

One consists of lowering the average income credit from 85 to 75 percent of base period.

Another is the increase in the ceiling rate, over-all taxation, from 62 to 72 percent.

The third is the provision which would limit the surtax exemption in the minimum excess-profits credit of related corporations to a single unit.

All of those are simply indirect methods of increasing the amount of excess-profits taxes which are collected.

Senator KERR. Does your industry in the business of operating transportation in many States find it necessary to incorporate sometimes in more than one State?

Mr. IDOL. Very frequently, sir.

That is not——

Senator KERR. All right, go ahead.

Mr. IDOL. An essential to operation in some cases, but in many States it is compelled as a method of securing the normal registration fees.

It gets to be a rather complicated subject to attempt to described exactly, but that situation does exist in a number of localities.

I have attached to my statement an exhibit which shows income statistics for class I intercity motor carriers of property for the years 1939 through 1950, the last being estimated.

The balance of them are all taken from official figures of the Interstate Commerce Commission.

I would like you to note particularly that in the year 1945 this industry, as a class, lost money. Our class payment to the Government decreased—this is not, by the way, a complete statement of the whole industry, of course, it is much larger than that, but it does list all so-called class I carriers of property regulated by the Commission, so I think you can take it as being a representative statement.

In 1942, the carriers—this group of carriers—paid something over 12 millions in taxes to the Government.

In 1945 that payment had been cut to under $4 million, and the industry was in a deficit position after those taxes were paid.

In 1949 under relief from excess taxation and, of course, with the ability to obtain equipment, supplies, which were short during World War II, our tax payments came up to $31,000,000 and we estimate them at $62 million for that same group in 1950.

I think there is no question but that the motor carrier industry will pay the Government more tax revenues at rates under 50 percent than it will at rates over 50 percent.

We have very little of investment capital in our business. It is made up almost entirely of relatively small companies who have had to plow back any earnings they get into the business, and their growth is limited by that ability to supply out of earnings the capital necessary to expand.

You have given in the last tax bill special treatment to all public utilities, including the transportation of property by motor vehicle. That is found in, I believe, section 448 of the 1950 act. I have the exact reference in my statement somewhere.

But, in any event, that is of absolutely no use to the common carrier by motor vehicle.

It is useful, I believe, to every other type of public utility, and all of the rest of them have investments which range from three to four times their annual revenues.

To keep 6 cents out of their revenue dollar after taxes, they must keep about 30 to 40 cents out of their revenue dollar. I mean, to keep 6 percent on their investment, they must keep about 30 to 40 cents out of their revenue dollar.

The motor carrier, on the other hand, has an average annual revenue of from 4, 5, to 10 times his investment. To measure his proper rate of return by a return on investment is an impossibility.

It has been recognized by the Interstate Commerce Commission and a number of State commissions in fixing rates of return, and they look first to the ratio of revenue to expense, rather than to any fixed rate of return on investment.

The motor carrier industry can be very prosperous by keeping from 10 to 15 cents out of its revenue dollar, before taxes. We urge that we get the same, in effect, the same relief you have given other public utilities in very slightly different form.

I have suggested the exact language for an addition to section 448, which will allow motor carriers to measure their normal profits by the ratio of expense to total revenue.

I hope that you gentlemen will consider that in the revision of this tax situation.

Thank you very much.

Senator Byrd. Thank you very much.

(The prepared statement follows:)

STATEMENT OF EDGAR S. IDOL

Mr. Chairman and gentlemen of the committee, my name is Edgar S. Idol. I am general counsel of the American Trucking Associations, Inc., the national trade association of the trucking industry. ATA is a federation of State associations, which include as their members substantially all of the 19,000 for-hire carriers under the jurisdiction of the Interstate Commerce Commission, and also the bulk of the some 300,000 local for-hire operators. ATA, through its State associations, also represents many thousands of private motor carriers. Our offices are at 1424 Sixteenth Street NW., Washington 6, D. C.

EXCISE TAXATION

Eminent authorities on tax questions have recommended to the Congress that a large percentage of the revenue required to put the country on a pay-as-you-go basis be raised from excise taxes. We have no argument with these recommendations on general policy. In fact, we strongly favor the recommendations of the Committee for Economic Development, which urges the enactment of a general 5-percent excise tax, with no increases on items currently subject to excise taxation above that figure.

But we are very much concerned by the action of the Ways and Means Committee of the House in proposing an increase of one-half cent per gallon in the current Federal gasoline tax, an increase of from 5 to 8 percent in Federal excise taxes on trucks and accessories, and the establishment of a 2-cent tax on Diesel fuel used in highway vehicles only. At page 42 of the report of the Committee on Ways and Means, it is indicated that the increase of one-half cent per gallon in gasoline tax is based upon the theory that the 1939 ratio of tax to the retail price should be restored. The committee says "Although in 1950 the tax was 6 percent of the retail price, including tax, in 1940 it was 8½ percent of the retail price." The committee further states that "Under these conditions, it appears probable that an increase in the gasoline tax of the size provided by this bill can readily be passed on to the consumers of gasoline" although it is further admitted that "too substantial an increase in the gasoline tax by the Federal Government might affect the use of this revenue source by the States."

The proposed 2-cent-per-gallon tax on Diesel fuel is explained by the statement "Your committee believes that the taxation of Diesel fuel used on the highways on the same basis as gasoline is necessary in order to prevent discrimination against vehicles powered by gasoline."

I would first like to direct this committee's attention to the fact that there is no attempt to justify either the increase in the gasoline tax or the new tax on Diesel fuel on any equitable ground. To repeat, the only statement we have by the House committee with respect to the equity of the situation is that "an increase in the gasoline tax of the size provided by this bill can readily be passed on to the consumers of gasoline." The House committee itself recognized that the tax was inequitable. At page 42 of the report appears the following statement: "Payments for gasoline represent costs of doing business in the case of gasoline consumed by trucks." We pointed out to the House committee that there was no equitable ground for any Federal tax on gasoline.

There seems to be a general impression that special taxes by the Federal Government on users of highways may be justified by Federal contributions to highway construction and maintenance; I shall not take the time of this committee to argue that point. So far as any increase in present Federal excise taxation is concerned, it is only necessary to point out that Federal excise collections from highway users currently exceed Federal aid to highway construction by more than $1,000,000,000 annually. Proposed increases in highway-use taxes are justified only on the ground of expediency and ease of collection.

We urge this committee to examine the equities of the situation more closely before acting on the House proposals. As we have already shown, the Federal Government is doing nothing for highway users which justifies increased excise taxation on the basis of benefits received. We ask that this committee take a further look at the extent to which State governments have tapped highway users as a source of general revenue.

During the year 1949, the last for which complete figures are available, highway users paid to State and Federal Governments a total of $3,010,620,000 in special highway taxes. These collections exceeded expenditures on State-administered highways by more than one and one-half billion dollars. Of the total special taxes collected from highway users, the Federal Government took as its share $1,304,500,000, of which $332,000,000 was collected from the truck and bus industry. Collections by State governments amounted to $2,306,120,000, of which the truck and bus industries contributed $730,180,000.

During the last 6 months the several States have substantially increased their special taxes on highway users, particularly commercial trucks. Eleven States have increased their gasoline and Diesel fuel taxes by amounts ranging from 1 to 2 cents per gallon. Fourteen States have increased charges for the operation of commercial trucks, principally through increased registration fees. An outstanding example is noted in the legislation adopted by New York, where a special ton-mile tax was enacted, which, for heavy commercial trucks, is the equivalent of an additional gasoline tax of from 10 to 12 cents per gallon.

For the past 20 years, highway users, and particularly commercial trucks, have been a favorite target for legislators seeking new tax revenue. Unfortunately, for the trucking industry, the fact that special taxes have heretofore been levied upon and paid by the industry seems to be regarded as sound precedent for levying and collecting still more special taxes. The only justification for special taxes on highway users is found in the cost of constructing and maintaining highways. There is no justification for any Federal tax on this basis.

The House committee explains its proposed tax on Diesel fuel on the ground that it is "necessary in order to prevent discrimination against vehicles powered by gasoline." That argument cannot stand analysis. The House proposal does not remove a discrimination; it simply extends a discrimination to a slightly larger group of users. All users of gasoline are now being unjustly discriminated against. To now enact a tax on Diesel fuel, limited to that which is used in highway equipment, is to simply emphasize and narrow the present discriminatory practice. If the Congress decides that, because of ease of collection, a Federal tax should be laid upon users of Diesel fuel, there should be no limitation to use in commercial highway vehicles. There is certainly no more reason for Federal taxation of Diesel fuel consumed by highway motor vehicles than for Diesel fuel consumed by railroad locomotives. The gasoline tax contains no such discriminatory limitation. It is applicable to gasoline sold, without regard to its use. If the purpose of the Congress is to remove a discrimination against gasoline, then the proper course is to apply the current 1½-cent Federal tax to all sales of Diesel fuel, regardless of whether it is consumed in highway vehicles or in other industrial engines.

The proposal to increase excise taxation on automobile trucks, buses, and truck trailers is covered at page 44 of the House committee's report. The inflationary angle, given as the reason for increasing the gasoline tax, is not applicable here since the tax rate is related to sales price. The committee gives no real reason for this increase. The application of an increased percentage rate to the equipment in question is excused rather than explained by the language "It is believed * * * desirable * * * (because of) the anticipated highway demand for this type of automotive transportation coupled with the likelihood of a curtailment in the supply available."

There will be no drastic curtailment of the supply of equipment available. Representations of commercial highway users to the National Production Authority have assured a reasonably adequate supply of equipment for the essential services of highway carriers. In short, the only real reason for the House committee proposal is that the tax can be collected from a group of users who have already borne a discriminatory tax for a considerable period of time and managed to survive.

The only reason given for the increased rate of tax on automotive parts and accessories is, as stated at page 44 of the House committee's report, "This will retain a uniform rate of tax for these two types of items, as is provided by present law." In other words, the House committee feels that it is better to have uniform discrimination than nonuniform discrimination.

Under the present political and economic situation, the motor carrier industry recognizes the impracticability of seeking relief from present discriminatory excise taxation. But we think there is no excuse for increasing the measure of discriminatory treatment under which we suffer. And we strongly urge adoption by the Congress of the recommendation made by the Committee for Economic Development: "After this bill is passed the Joint Committee on Internal Revenue Taxation initiate a study of Federal excises with a view to rationalizing the structure at the earliest appropriate time."

The CED cannot be considered a pressure group for any particular line of business activity. Its membership crosses all industrial lines, and its policies are directed by outstanding men from every branch of industrial life. We think their approach to the current tax problem is the soundest of any that we have seen, and we urge careful consideration by this committee of their recommendations.

EXCESS PROFITS TAXATION

We have previously brought to the attention of this committee, and to the attention of the House Ways and Means Committee, the tremendous impact of so-called excess profits taxation on the motor carrier industry. Exhibit I, attached hereto, gives a graphic picture of what happened to the trucking industry under the excess profits tax law of World War II, and of the subsequent recovery of the industry under normal taxation. Except for 1950 estimates, for which final figures are not yet available, the exhibit reflects only official figures compiled from the reports to the Interstate Commerce Commission by class I intercity motor carriers of property. Gross revenue of these carriers increased fom $378 million in 1939 to $746 million in 1945, but taxable income decreased from over $17 million in 1939 to less than $2 million in 1945. Average net income after taxes decreased from over $18,000 in 1939 to a deficit of $1,500 in 1945. Since the war, under less drastic tax rates, these carriers have increased their business more than three times and tax payments of less than $4 million in 1945 increased to over $62 million in 1950.

With income-tax rates under 50 percent, the industry can continue to grow and the Government's tax income will continue to grow. At tax rates exceeding 50 percent growth will be stifled and at rates beyond 60 percent the industry is bound to shrivel.

None of the growth or relief provisions of the 1950 revenue bill give adequate relief to motor carriers. The need of public utilities generally for relief from excess taxation was recognized by the Congress in the enactment of a special provision, section 448 of the 1950 act, under which all forms of transportation as well as the gas, telephone, and electric utilities are given treatment which recognizes their special position. But, as we told both the House and Senate committees, the provision is of absolutely no benefit to motor carriers.

The reason is that this special treatment for utilities consists of eliminating excess profits taxation from a fixed percentage of involvement, but gives no recognition to the ratio of expense to revenue. For most utilities whose rates are regulated in the public interest by State or Federal agencies, a return of 6 or 7 percent on investment is recognized as adequate. The railroad industry, for example, shows an average rate of return of less than 4 percent under normal conditions. But all of these utilities, excepting only the common carrier by motor vhicle, have investments three to four times annual revenues, and must retain 30 to 40 cents out of every revenue dollar as profit before taxes in order to show a 6 to 7 percent rate of return. Motor carriers, on the contrary, have annual revenues ranging from 3 to 10 times investment, and without excess taxation can maintain a reasonably healthy financial condition on operating ratios of 85 to 90 percent.

The Interstate Commerce Commission, and a number of State commissions, have recognized this essential difference between motor carriers and other utilities, and fixed reasonable rates of return on the basis of operating ratios rather than on the basis of a return on investment.

We urgently renew our request of this committee for consideration of our special need. Appropriate revision is simple. We suggest the addition to subparagraph (a) of section 448 of the following language: "or subsection (f) whichever amount is the larger.", and the addition of a new subsection (f) reading as follows:

"(f) ALTERNATIVE COMPUTATION.—For motor carriers described in subparagraph (c) (1) (C), the amount referred to in subsection (a) shall be 6 per centum of operating revenue."

The enactment of such legislation would do no more than give to common carriers by motor vehicle recognition of their special public-service status similar to that which has been given other utilities. Unless the industry can retain 6 cents out of it revenue dollar after taxes, it will not long be able to provide the service to the public essential to both the defense program and the normal growth of the country.

Three changes are proposed in the present tax law by the House committee, which will have a throttling effect upon the motor-carrier industry. They are:

1. Restriction of the surtax exemption and the minimum excess-profits credit of related corporations;
2. The reduction of excess-profits credit from 85 percent to 75 percent of average base period net income;
3. The increase in the ceiling on total corporate taxation from 62 to 70 percent.

If, as a matter of policy, the committee decides not to revise the 1950 law so far as it relates to excess taxation, the changes will not, of course, be given consideration. But if revision is undertaken at this session of the Congress, we earnestly urge that these amendments be rejected. All three are nothing more or less than a roundabout method of increasing taxes on so-called excess profits. Because the excess-profits tax strikes with unusual force against growing businesses, any increase in the rate of tax or of the total charge hits the growing business just that much harder.

Exhibit I, attached hereto, shows clearly how vulnerable the trucking industry is to so-called excess-profits taxation. Earnings disappeared entirely under the World War II law; both the carriers and the Federal Treasury suffered as a result. Freed of excessive tax burdens in 1946, the business rebounded with all the vigor to be expected of a young industry, but still lagged behind the normal demand for transportation service by highway even in pre-Korea days.

Because of the normal growth of his business, the average class I carrier had taxable income in 1950 which exceeded his credit by 38 percent. He therefore must pay excess taxes on 38 percent of his income. That taxable income is neither excessive, nor is it income attributable to the defense program.

We urge the committee not to subject our vital industry to the kind of taxation which almost put us in bankruptcy during World War II. The best argument which can be made on this point has been very forceably presented to the committee by Mr. J. Cameron Thomson for the CED. We fully endorse that presentation and urge its acceptance by this committee.

EXHIBIT I.—*Income, statistics—Class I intercity motor carriers of property, 1939–50*

	1939	1940	1941	1942	1943	1944
Number of carriers	957	991	1,076	1,083	1,165	1,337
Revenues	$378,473,829	$431,052,674	$560,166,612	$587,869,636	$645,673,297	$710,909,895
Average per carrier	$395,479	$434,967	$520,601	$542,816	$554,226	$531,720
Taxable income	$17,597,783	$17,461,406	$25,272,871	$29,882,920	$18,728,766	$14,894,618
Average per carrier	$18,388	$17,620	$23,411	$27,593	$16,076	$11,140
Income taxes	$2,703,649	$4,199,879	$7,685,547	$12,625,023	$9,290,948	$7,116,329
Average per carrier	$2,825	$4,238	$7,143	$11,665	$7,980	$5,323
Operating ratio	95.1	95.6	95.2	94.7	96.9	97.9
Ratio of net income to revenue	3.9	3.1	3.1	3.0	1.5	1.1

	1945	1946	1947	1948	1949	1950, estimated
Number of carriers	1,445	1,516	1,603	1,825	1,817	1,817
Revenues	$746,393,799	$883,806,303	$1,232,546,162	$1,662,881,090	$1,857,919,516	$2,322,399,395
Average per carrier	$516,536	$582,986	$768,900	$922,542	$1,022,520	$1,278,150
Taxable income	$1,655,801	$30,047,911	$54,428,622	$107,424,005	$94,977,987	$139,343,964
Average per carrier	$1,146	$19,821	$33,954	$58,863	$52,272	$76,689
Income taxes	$3,883,092	$9,027,803	$17,416,594	$35,240,906	$31,546,162	$62,704,784
Average per carrier	$2,687	$5,955	$10,865	$19,551	$17,362	$34,510
Operating ratio	99.8	96.4	95.3	93.4	94.7	94.0
Ratio of net income to revenue	−3.0	2.4	3.0	4.3	3.4	3.5

Source: 1939–49—Official Report of Carriers to Interstate Commerce Commission; 1950—estimate based on trend indicated in first half.

Senator BYRD. Our next witness is Alfred Krebs. Will you please identify yourself, Mr. Krebs.

STATEMENT OF ALFRED U. KREBS, COUNSEL, NATIONAL FEDERATION OF AMERICAN SHIPPING, INC.

Mr. KREBS. Mr. Chairman, my statement is very short, so if you have no objection, I would like to read it rather than summarize it.

My name is Alfred U. Krebs. I am general counsel for the National Federation of American Shipping, Inc., an organization representing a majority of all deep-water privately owned dry-cargo American-flag shipping and a large segment of the American-flag tanker fleet.

I am appearing in opposition to section 493 of H. R. 4473, Revenue Act of 1951, which would impose a 3-percent tax on the "fair charge" for the transportation of petroleum and petroleum products between points in the United States where such products are transported by oil companies in their own tankers.

The "fair charge" for such transportation would be computed on (1) the basis of the charge for such transportation made by persons performing like transportation for hire, as determined by the Secretary of the Treasury; or (2) if no such charge exists, then on the basis of a reasonable charge for such transportation, also as determined by the Secretary.

The proposed tax would be highly discriminatory with respect to the tanker industry. Numerous other shippers transport their own property in their own vehicles and are not subject to any such tax. The tanker companies should not, under such circumstances, be required to pay for the privilege of transporting their own property in their own vessels. If a tax of this nature is to be imposed, it should be levied on all transportation of all property by the owners.

The Committee on Ways and Means of the House attempts to justify imposition of the proposed tax by pointing out in its report on the bill that a similar tax is levied on the private transportation of oil by pipeline.

Senator KERR. Let me ask a question there. A transportation tax is levied on coal where it is hauled by public utilities, is it not?

Mr. KREBS. Yes, sir; that is for hire, I believe.

Senator KERR. Well, that is the same as pipelines for hire.

Mr. KREBS. Yes, sir; that is true. I go into the distinction between the pipeline situation——

Senator KERR. If a fellow owns a coal mine and hauls coal, he would not be taxed?

Mr. KREBS. Not to my knowledge. There is no tax on such transportation at the present time if he transports his own products.

Senator KERR. So that any competitor who produces any commodity whether it is coal or limestone or gravel, has a tax charged on the transportation of it if the railroad carries it, but does not have it if he transports it himself.

Mr. KREBS. Yes, sir; that is correct.

Senator KERR. You position is that if they are going to pick those commodities that are privately transported they should pick them all out?

Mr. KREBS. That is correct. We would not like to see that occur, but if a tax of this nature is imposed, it should be imposed on all private transportation of this nature.

There is little, if any similarity between the transportation of oil by pipeline and by tanker. The companies owning and operating the pipelines are "common carriers" within the meaning of the Interstate Commerce Act, and as such are subject to regulation by the Interstate Commerce Commission. They are required to file tariffs and to furnish transportation upon request. This is not so in the case of the tanker companies.

These differences between the two forms of transportation would be responsible for considerable difficulty in administering the tax on movements by water.

In contast to fixed pipeline tariffs, tanker rates are based upon conditions prevailing at the particular time for the carriage of the particular type of product.

There are "winter" rates and "summer" rates. There are rates based upon the size, type, and speed of the vessel, as well as upon the quantity, grade, and type of product to be transported. Fluctuations in the oil market alone result in sharp changes in tanker rates.

We believe that administration of the proposed tax would require the Secretary to have an army of experts who would be familiar with charges for the transportation of petroleum and its liquid products by water at all times and under all conditions.

Even if this were possible, we think that proper administration of the proposed tax would constitute an almost impossible task.

In that connection, I would like to refer to a statement that has been referred to by a previous witness on this subject, which appears in the data on proposed revenue bill of 1942 submitted to the Ways and Means Committee by the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation April 24 to June 27, 1942.

The statement that I am going to refer to appears on page 442, exhibit 212, transportation of property tax. This is the statement:

> It would be administratively impractical to extend the tax to cover those businesses that conduct their own transportation service. In the absence of published rate schedules, it probably would be necessary to base the tax on the cost of conducting such service. This determination, for literally hundreds of thousands of taxpayers, seems an almost impossible task.

That is the end of the statement appearing in the data, the data on the proposed revenue bill of 1942.

Senator KERR. Is that a statement made by the Treasury itself?

Mr. KREBS. Yes, sir.

Their statement was referred to by a previous witness testifying on this particular section of the bill.

Senator BYRD. Made by the Treasury Department?

Mr. KREBS. Yes, sir; it was taken from the data on proposed revenue bill of 1942 submitted to the Ways and Means Committee by the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation, April 24 to June 27, 1942.

The fact that the proposed tax singles out the private transportation of petroleum and its products by water to the exclusion of all other products which are privately transported, is justification enough for deleting section 493 from H. R. 4473, and we respectfully urge that your committee do so.

Senator BYRD. Thank you very much, Mr. Krebs.

Mr. KREBS. Thank you, sir.

Senator BYRD. Mr. Freed?

STATEMENT OF CHARLES C. FREED, NATIONAL AUTOMOBILE DEALERS ASSOCIATION

Mr. FREED. Mr. Chairman and members of the Finance Committee, my name is Charles C. Freed.

I am a DeSoto-Plymouth dealer in Salt Lake City, Utah.

I am appearing here at this hearing in my capacity as chairman of the Public Affairs Committee of the National Automobile Dealers Association.

The 34,000 members of our association employ approximately 800,000 people who serve 50 million car and truck owners of this country. Our members sell more than 90 percent of the new cars and trucks sold.

We are close to the motorists of the Nation. We think it necessary to bring certain salient facts—which we have learned from them—to your attention today as this committee studies the complex problem of finding ways and means to finance an increased program of spending for national defense.

We are grateful that you are hearing our testimony. We speak not so much for ourselves as small-business men, but for our customers—the 50 million motorists who buy their cars and trucks from us—who will all be seriously affected if the proposed tax increases become law.

Mr. Chairman, in the interest of time, I am going to deviate some from my prepared statement, and make it as brief as possible and ask kindly that our full statement that you have become part of the record.

Senator BYRD. Yes, that will be done.

Mr. FREED. Even under the present law there are obvious injustices to the motorist; under the proposed law even greater burdens are placed upon him.

In order to weigh the wisdom of imposing any increased taxes on automobiles, trucks, parts, and accessories and gasoline, we believe that it is necessary to ask ourselves these questions:

First, has there been any change in the original and basic philosophy that excise taxes were to be imposed on luxuries and luxuries alone?

Second, is the automobile essential—necessary to our way of living and to our economy?

If it is, and if excise taxes are for luxuries alone, then automobiles should not be subjected to any increased excise tax.

Senator TAFT. I think you can take out the theory that it is on luxuries.

Mr. FREED. Thank you, sir.

Senator TAFT. There are so many of these taxes which are not on luxuries—I mean, take telegraph and telephone taxes——

Mr. FREED. That is right.

Senator TAFT. A whole series of others that there is no theory of with respect to the excise tax.

Mr. FREED. We wondered about that because of champange and perfume.

Senator TAFT. There is no theory underlying that that I know of.

Senator KERR. Excise taxes are one thing that would conform to the principle that it is not a theory, but a reality.

Mr. FREED. Yes; that is right.

Senator WILLIAMS. It is considered a little bit more diplomatic than calling it a sales tax.

Mr. FREED. That is right.

Transportation by passenger cars is so important to defense workers that one Senator in a recent debate on the Senate floor called the automobile a "war necessity." Surveys conducted during World War II showed that at one aircraft plant, 92 percent of the employees used the automobile for transportation to and from work; at a naval ordance plant 95 percent depended on the automobile for transportation.

Today, decentralization is encouraged as expedient to defense and health. Workers and plants are moving from many cities to localities which have no public-transportation facilities. A look at the new census figures will show that in Pittsburgh, for example, the population growth has been only 2 percent in the city to 98 percent in the outlying sections.

Workers in many newly developed areas must rely solely on the passenger car for their transportation. For example, gentlemen, in my home town in Salt Lake City, the mines and defense plans now being worked to capacity in this emergency can be reached only by automobile transportation.

When public transportation is at a standstill—as was recently proved in the 3-day strike in Washington and in the 59-day strike in Detroit—the people of this country were able to carry on their activities, necessary to living, through passenger automobiles.

What happened in Washington and Detroit is a daily occurrence in many towns and cities in this country. There are 25,000 communities without any rail service whatsoever. There are 2,074 communities which are solely dependent on the automobile for transportation, as they have no public transportation at all.

Before even considering what the proposed increases in automotive excises would mean to the average car buyer, let us look at the taxes which he already pays under present rates.

First, let us look at these taxes through the eyes of the average worker, the way he must look at them, in terms of the dollars and cents they add to his car's costs rather than as the astronomical figures which they yield to the Treasury. We will discuss these taxes from the standpoint of their yield later.

Let me remind you that the automobile differs from the other products on which a Federal excise tax is imposed, not only because of its essential usefulness, but because the automobile represents a continuing source of tax revenue to Federal, State, and local governments.

It is the average worker who constitutes a majority of the Nation's car owners. According to statistics released by the Federal Reserve Board, he earns less than $77 a week before taxes. Yet, when our average worker buys a new lower-priced car delivered in Detroit, Mich., taxes constitute an estimated $475 of its total cost of $2,000.

Senator BYRD. Let me ask you, does that include the income tax?

Mr. FREED. Yes, sir. We have an explanatory note on that.

That, Senators, is 24 cents out of every car buyer's dollar, and that is the current tax without a single cent of the additional levies included in the House bill.

Throughout the life of his car, he must pay both Federal and State sales taxes on all future purchases of gasoline and oil. Whenever his car needs repairs involving replacement parts or new tires and tubes, he will be paying additional excise taxes on these.

Each year, of course, he will pay State gasoline taxes, license fees, and in many States sizable property taxes on his essential vehicle.

The worker in Hartsville, S. C., for example, must pay even under present tax rates, a total of $560.15 in taxes when he buys a $2,000 automobile. That is more than 28 cents out of every dollar expended on a new car by a South Carolina worker. And he, too, is only beginning to pay taxes on his car and its operation.

The $560.15 tax cost of his new car includes, of course, not only current excise taxes on the automobile, its tires, oil, gas, radio, and heater but many State and some city levies and the proportionate part of manufacturer's and dealer's taxes. All of these taxes, directly or indirectly, come out of the car buyer's pockets.

For the purchase of a product as essential as the automobile, $560 is a terrific tax burden for the average worker who makes only $77 a week before taxes.

If the automotive and gasoline tax excise increases proposed in the House bill should become law, this same Hartsville worker would have to pay nearly $610 in taxes for the same car which currently retails at $2,000. Naturally, the retail price would have to reflect the full amount of these tax increases.

These increases would result from raising the excise tax on automobiles from 7 to 10 percent and the tax on automotive parts and accessories from 5 to 8 percent—both of which are included in the House bill.

Senator TAFT. What was the theory of the House bill? Was it some theory that the use or the sales of automobiles should be cut down during the defense program?

Mr. FREED. I think that was the original theory, Senator Taft, and it certainly would accomplish this.

We are almost priced out of the market now, we believe.

I submit, Senators, that present levies already impose an unjust and discriminatory burden on the car buyer, forcing him to bear far more than his just share of the tax load.

This is equally true of the truck buyer, who under the House bill would be confronted with a 60 percent increase in his already high Federal excise taxes—a boost from 5 to 8 percent.

The same tax increase would apply likewise to the automotive repair parts and accessories he requires to keep his truck operating. Finally, he would also be affected by the proposed increase in the Federal gasoline taxes.

The automobile is without doubt the most heavily taxed essential possession of the average American today. Where Federal taxes stop, State and city taxes begin and the automobile and the truck are taxed again and again.

During the current year, motor-vehicle owners will hand over to the States alone a record $3,000,000,000 for the ownership and use of their essential vehicles. This is almost as much as the States derived from all taxes just a decade ago.

Now, let us consider the estimated Federal revenue expected from the proposed changes in manufacturers' excises under both the present law and the House bill. Since Secretary of the Treasury Snyder's estimates of revenue to be realized under both the current and House bill rates are extremely conservative, we will use the estimates he presented to this committee on June 28.

Manufacturers' excise taxes are grouped in 11 product categories, with the present and House bill tax rates and the estimated revenue from each, under table 3, item III in Secretary Snyder's presentation.

For your convenience a copy of that portion of the Secretary's presentation is attached to your copy of my testimony. It covers all the manufacturers' excises with which we are concerned, and I want to call your attention to the fact that Secretary Snyder's own figures conclusively prove:

First, the current automotive-tax rates discriminate unfairly against the car or truck buyer and owner in that they far exceed in both rate and yield excises levied on even the comparatively few other types of products, many of them less essential than cars and trucks, subjected to such a tax.

This is shown by the fact that the five excises levied on cars and trucks and their operation—the present 1½-cent-a-gallon tax on gasoline, the 7-percent excise on automobiles, the 5-percent levy on automotive parts and accessories, the 5-percent levy on trucks and busses, and the 5 cents and 9 cents per pound tax on tires and tubes—yield more than 82 percent of the total revenue obtained from current manufacturers' excise-tax levies.

In dollars and cents, the automotive levies under the present law place an estimated——

Senator KERR. Just a minute.

You say will yield more than 82 percent of the total revenue obtained from current manufacturers' excise-tax levies.

Mr. FREES. That is correct, sir.

Senator KERR. What you are telling us there is that the automobile owner——

Mr. FREES. Yes, sir; as such, pays——

Senator KERR. Eighty-two percent of the total amount of excise tax being collected.

Mr. FREES. That is right.

Senator KERR. By the Federal Government?

Mr. FREES. Yes, sir. We go into that a little more thoroughly later on.

In dollars and cents the automotive levies under the present law place an estimated $1,425,000,000 in the Treasury while the manufacturers' excises, applying to nonautomotive products, bring in a total of only $310,500,000.

Second, and this is particularly important, the House bill would make this present discrimination against the motorist and truck operator even far greater by increasing automotive excises so that they would yield an estimated $502,000,000 more annually than under current rates.

At the same time, the House bill eliminates and reduces more levies on nonautomotive items than it increases. As a result of this reshuffling, it actually lowers the over-all tax yield from nonautomotive items a total of $90,800,000. When this revenue loss on nonautomotive items is subtracted from substantial proposed increases in the automotive levies, the net gain to the Treasury will be $411,200,000. But the fact remains, Senators, that car and truck owners would be taxed an additional $502,000,000 to obtain the $411,200,000 gain.

I hasten to add that the automobile dealers of this country certainly do not object to the reduction in manufacturers' excises provided in the House bill on the nonautomotive products that have been taxed at varying rates.

But, we do object, on behalf of the Nation's car buyers and owners, to increasing the obviously discriminatory excises against our customers. Maintaining automotive excises at current levies would simply continue the discriminatory taxing of two of our country's most essential and most tax-burdened products, the family car and the truck.

Moreover, past experience has proven that when taxes are increased, even though the increases are adopted as "emergency" and "temporary" measures, the tax increases long outlive the Congressmen who originally voted for them.

Senator KERR. You are not dramatizing the lack of longevity on the part of the Congressmen?

Mr. FREED. We have in mind the luxury tax on automobiles in 1917, Senator.

Senator KERR. I did not understand you to say that luxury taxes were on the Congress but——

Mr. FREED. No; that is definitely right.

Senator KERR. All right.

Senator WILLIAMS. You say that the automobile industry accounts for 82 percent of the excise taxes?

Mr. FREED. Of the total excise taxes.

Senator TAFT. Manufacturers'.

Mr. FREED. That is right.

Senator WILLIAMS. You are excluding the tobacco and liquor taxes?

Mr. FREED. Yes, sir; that is right. That was in Secretary Snyder's testimony, and we took the figures from that.

This is a particularly serious matter when the product is also the main revenue producer for the States.

In addition you gentlemen know even better than we do that when you tax a product and its use beyond the ability of the public to pay, you have also reached the point of diminishing returns from tax levies.

Although wages are at high levels today, it is also true that many essential workers have fewer dollars for spending since both income-tax rates and the prices of virtually all essential items, particularly food, have risen sharply.

Senator BYRD. Mr. Freed, let me ask you this question: There have been four increases in taxes on automobiles before.

Which ones do you think—which one is the most objectionable?

Mr. FREED. I think the increase on passenger cars and trucks and excise——

Senator BYRD. In other words, the increase from 7 percent to 10 percent?

Mr. FREED. To 10 percent.

Senator BYRD. Which brings in $196 million.

Mr. FREED. Yes.

Senator BYRD. You think that is the most objectionable?

Mr. FREED. I certainly do.

I think it is extremely objectionable, because on the average low-priced car it will mean an increase of approximately $50 in the buyer's price of the car, and we additionally think that the increase from 5 to 8 percent on essential parts, necessary parts to keep the man's car operating, is certainly most objectionable.

Senator BYRD. That brings in $56 million?

Mr. FREED. Yes.

Senator BYRD. And the increase on trucks, busses, and trailers—that has been increased from 5 to 8 percent.

Mr. FREED. Yes. We are astounded on that 60-percent increase there on a certainly highly essential and necessary product.

Senator BYRD. In other words, you think the gasoline tax can be better absorbed than the other excise taxes?

Mr. FREED. Yes; because it is spread out all over on so many more people.

Senator Byrd. And that is in proportion to the use of the car, also?

Mr. Fagen. Yes, sir; that is correct.

Depriving these large groups of the dependable cars and even necessary repair parts for their present vehicles through excessive taxation certainly will not add to Federal revenue, and at the same time will cut into the principal revenue of most, if not all, States.

It is gratifying to note that this Congress has been seeking ways and means to curtail Federal expenditures. We are, of course, interested and appreciative of your work in cutting nondefense spending.

We have also been impressed with the consideration this committee is giving to closing further loopholes in the present tax program. To us, the defense program is everybody's job. It is everybody's responsibility. To make it so, everyone should pay his share. To accomplish this, we would suggest that other sources of revenue be obtained from fields of business not now taxed.

Perhaps this committee will also find it expedient to give further consideration, as has been proposed by others appearing here, to some form of a general manufacturers' tax across the board. A tax of this type would prove, we feel, more equitable, fairer to everybody.

Such a tax might mean that it would be possible to reduce some of the more objectionable features of the proposed tax bill which you are considering. I refer specifically to the excess profits tax and the increase on personal income.

Senators, let us always remember that there is a grave danger in going beyond, in taxation, what our private enterprise system can stand. Taxes can—and already are threatening—to destroy all initiative to produce.

No selected segments of American industry nor of the Nation's population should at any time—in an emergency or otherwise—be called upon to bear an inequitable share of the excise, or any, tax burden.

That applies with equal force to the excess-profits tax. Inequities in the present excess-profits-tax law are working a serious hardship on thousands of businessmen, including a great many automobile dealers.

In addition, even greater inequities and increased hardship would result from certain changes in the House bill, if it should be enacted into law.

We are seriously concerned and want to take this opportunity to endorse the testimony of representative automobile dealers, who have already testified before this committee. They have explained to you from their own experience the great need for equalizing the excess-profits-tax burden and removing its inequities so that all businessmen will be treated fairly.

As they explained, comparatively new corporations, both those which commenced business during the base period years and others launched since then, and those that are attempting to expand are placed under a severe and unfair tax handicap by the present law and by provisions of the House bill.

We will sincerely appreciate any corrective measures which this committee recommends that will remove these inequities and assure that the intent of Congress is followed in applying the excess-profits tax.

To summarize briefly, we have shown in our presentation on proposed automotive excise taxes:

First, that the average car buyer under present excise tax rates is paying from 21 to 28 cents in total taxes out of every automobile dollar expended.

Second, that the proposed increases in automotive excise taxes would add substantially to the inequitable and terrific tax load already heaped by the Federal Government, States, and even many cities on a highly essential product upon which the average worker and farmer must depend.

Third, that current automotive tax rates discriminate unfairly against the car or truck buyer also in that they far exceed in rate and yield similar manufacturers' excises on comparable products, many of them less essential.

Fourth, that the present discrimination against the car buyer would be made far greater under the House bill in that it would add one-half billion dollars to automotive excise levies while reducing the manufacturers' excise tax yield from nonautomotive items by more than $300,000,000.

Finally, we urge this committee to make whatever tax program it adopts temporary by stipulating a definite expiration date. On behalf of the Nation's workers and farmers, we further urge this committee to find a more equitable tax than automotive excise taxes and to make sure that the already overburdened motorist is not saddled with additional excise taxes far out of proportion to this just share. We urge Congress to continue to curtail Government expenditures, to close loopholes in the present tax laws, and to protect the public's mobility by removing harsh and discriminatory taxes.

That concludes my statement.

Senator KERR. Mr. Chairman, the Senator was asking for the yield of the present gasoline tax, and this witness has given that information on this exhibit.

Mr. FREED. I think I have given it.

Senator KERR. You have it here?

Mr. FREED. Yes, sir.

Senator KERR. $525 million?

Mr. FREED. Yes, sir.

Thank you, sir, very much.

(The prepared statement of Mr. Freed is as follows:)

STATEMENT OF CHARLES C. FREED ON BEHALF OF THE NATIONAL AUTOMOBILE DEALERS ASSOCIATION

Mr. Chairman and members of the committee, my name is Charles C. Freed. I am a De Soto-Plymouth dealer in Salt Lake City, Utah. I appear at this hearing in my capacity as chairman of the public affairs committee of the National Automobile Dealers Association. The 34,000 members of our association employ approximately 800,000 people who serve 50,000,000 car and truck owners of this country. Our members sell more than 90 percent of the new cars and trucks sold.

We are close to the motorists of the Nation. We think it necessary to bring certain salient facts—which we have learned from them—to your attention today as this committee studies the complex problem of finding ways and means to finance an increased program of spending for national defense. We are grateful that you are hearing our testimony. We speak not so much for ourselves as small-business men, but for our customers—the 50,000,000 motorists who buy their cars and trucks from us—who will all be seriously affected if the proposed tax increases become law.

Automobile dealers in this country—as well as the majority of our customers—accept the fact that there is a pressing need for a continued expansion of our defense program. We know that it will cost a great deal of money.

Yet we do not feel that the motorist should be singled out to bear the greatest proportion of the increased tax burden.

Even under the present law there are obvious injustices to the motorist: under the proposed law even greater burdens are placed upon him.

In order to weigh the wisdom of imposing any increased taxes on automobiles, trucks, parts and accessories, and gasoline, we believe that it is necessary to ask ourselves these questions:

> First, has there been any change in the original and basic philosophy that excise taxes were to be imposed on luxuries and luxuries alone?
>
> Second, is the automobile essential—necessary to our way of living and to our economy?
>
> If it is, and if excise taxes are for luxuries alone, then automobiles should not be subjected to any excise tax, let alone an increased excise tax.

There can be no question of the essentiality of the automobile today. We believe you will be interested in some facts which recent surveys have disclosed. For example, 50,000,000 people—54 percent of the adult population—ride in an automobile or truck daily. For what reason? "Transportation to work" is what 70 percent of the people who ride in automobiles say is their purpose of owning and driving a car.

Let me give you additional facts. Of the mileage traveled, 55 percent is for the purpose of livelihood or shopping. Of the trips taken, 77 percent is for livelihood or shopping.

Our experience with customers bears out the finding of the surveys—that 95 percent of those who buy automobiles use them wholly or in large part as essential tools.

Transportation by passenger cars is so important to defense workers that one Senator in a recent debate on the Senate floor called the automobile a war necessity. Surveys conducted during World War II showed that at one aircraft plant, 92 percent of the employees used the automobile for transportation to and from work; at a naval ordnance plant 95 percent depended on the automobile for transportation.

Today, decentralization is encouraged as expedient to defense and health. Workers and plants are moving from many cities to localities which have no public transportation facilities. A look at the new census figures will show that in Pittsburgh, for example, the population growth has been only 2 percent in the city to 98 percent in the outlying sections. In Chicago and Detroit the ratio has been 35 percent growth for the city to 65 percent for their metropolitan areas.

Workers in many newly developed areas must rely solely on the passenger car for their transportation. For example, Senators, in Salt Lake City the mines and defense plants now being worked to capacity in this emergency can be reached only by automobile transportation.

When public transportation is at a standstill—as was recently proved in the 8-day strike in Washington and in the 59-day strike in Detroit—the people of this country were able to carry on their activities, necessary to living, through passenger automobiles. What happened in Washington and Detroit is a daily occurrence in many towns and cities in this country. There are 25,000 communities without any rail service whatsoever. There are 2,074 communities which are solely dependent on the automobile for transportation, as they have no public transportation at all.

The surveys showed further that the use of the automobile is not restricted to specific income groups, nor is it restricted to any occupational groups. No, gentlemen, the automobile is an essential product—essential to the cotton-mill worker in the South, the farmer in the Middle West, and the miner in the far West.

Before even considering what the proposed increases in automotive excises would mean to the average car buyer, let us look at the taxes which he already pays under present rates. First, let's view these taxes through the eyes of the average worker, the way he must look at them, in terms of the dollars and cents they add to his car's costs rather than as the astronomical figures which they yield to the Treasury. We will discuss these taxes from the standpoint of their yield later.

Let me remind you that the automobile differs from other products on which a Federal excise tax is imposed not only because of its essential usefulness but because the automobile represents a continuing source of tax revenue to Federal, State, and local governments.

It is the average worker who constitutes a majority of the Nation's car owners. According to statistics released by the Federal Reserve Board, he earns less than $77 a week before taxes. Yet when our average worker buys a new lower-priced car delivered in the automobile capital, Detroit, Mich., taxes constitute an estimated $475 of its total cost of $2,000. That, Senators, is 24 cents out of every car buyer's dollar, and that is the current tax without a single cent of the additional levies included in the House bill.

Moreover, when our average Detroit worker pays this tremendous tax bill in purchasing this essential product, he digs into his pocketbook for only the first 40 cents of Federal and State sales tax, levied on his initial 5 gallons of gasoline and 6 quarts of oil needed to power his new vehicle home.

Throughout the life of his car he must pay both Federal and State sales taxes on all future purchases of gasoline and oil. Whenever his car needs repairs involving replacement parts or new tires and tubes he will be paying additional excise taxes on these. Each year, of course, he will pay State gasoline taxes, license fees, and in many States sizable property taxes on his essential vehicle. Yes; the new car he purchases will be loaded with taxes not only when he buys it but also throughout its operation.

Even so, the Detroit worker buying a new car is confronted with less of a tax burden than the typical car buyer in many other States. The worker in Hartsville, S. C., for example, must pay, even under present tax rates, a total of $560.15 in taxes when he buys a $2,000 automobile. That is more than 28 cents out of every dollar expended on a new car by a South Carolina worker. And he, too, is only beginning to pay taxes on his car and its operation.

The $560.15 tax cost of his new car includes, of course, not only current excise taxes on the automobile, its tires, oil, gas, radio, and heater, but many State and some city levies and the proportionate part of manufacturer's and dealer's taxes. All of these taxes, directly or indirectly, come out of the car buyer's pockets.

For the purchase of a product as essential as the automobile, $560 is a terrific tax burden for the average worker who makes only $77 a week before taxes. But that is what he must pay under the present high automotive tax rates. Moreover, if the automotive and gasoline tax excise increases proposed in the House bill should become law, this same Hartsville worker would have to pay nearly $610 in taxes for the same car which currently retails at $2,000. Naturally the retail price would have to reflect the full amount of these tax increases.

These increases would result from raising the excise tax on automobiles from 7 to 10 percent and the tax on automotive parts and accessories from 5 to 8 percent, both of which are included in the House bill.

But, that is only part of the additional tax burden that would be placed on the average worker under the House bill. The 5 gallons of gasoline and the 6 quarts of oil required for our worker's first miles of driving and all subsequent purchases of gasoline and repair parts would be more costly due solely to increased tax levies. The tax on gasoline would be raised from the current Federal rate of 1½ cents a gallon to 2 cents a gallon and all replacement and accessory purchases in the future would carry an 8-percent excise levy instead of the current 5-percent tax. That's a 33⅓-percent increase in Federal gasoline tax and a 60-percent increase in the parts and accessories tax rates—terrific increases for an already heavily tax-burdened product so essential to the Nation's workers.

I submit, Senators, that present levies already impose an unjust and discriminatory burden on the car buyer, forcing him to bear far more than his just share of the tax load.

This is equally true of the truck buyer, who under the House bill would be confronted with a 70-percent increase in his already high Federal excise taxes—a boost from 5 percent to 8 percent. The same tax increase would apply likewise to the automotive repair parts and accessories he requires to keep his truck serving our country. Finally, he would also be affected by the proposed increase in the Federal gasoline taxes.

The automobile is without doubt the most heavily taxed essential possession of the average American today. Where Federal taxes stop, State and city taxes begin and the automobile and the truck are taxed again and again.

Moreover, many cities are now taking an additional tax bite out of the car owner's funds through the issuance of city licenses for which varying amounts are collected. Car owners in these cities are continually paying taxes to the Federal Government, to the State and to the city for the privilege of buying and driving a vehicle on which they must depend. The time has long since past when the impositon of even greater tax burdens on the motorist can be justified as fair and equitable.

During the current year, motor-vehicle owners will hand over to the States alone a record $3 billion for the ownership and use of their essential motor vehicles. This is almost as much as the States derived from all taxes just a decade ago.

Now, let's consider the estimated Federal revenue expected from the proposed changes in manufacturers' excises under both the present law and the House bill. Since Secretary of the Treasury Snyder's estimates of revenue to be realized under both the current and House bill rates are extremely conservative, we will use the estimates he presented to this committee on June 28.

Manufacturers' excise taxes are grouped in 11 product categories, with the present and House bill tax rates and the estimated revenue from each, under table 8, item III, in Secretary Snyder's presentation.

For your convenience a copy of that portion of the Secretary's presentation is attached to your copy of my testimony. It covers all the manufacturers' excises with which we are concerned and I want to call your attention to the fact that Secretary Snyder's own figures conclusively prove:

First, the current automotive tax rates discriminate unfairly against the car or truck buyer and owner in that they far exceed in both rate and yield excises levied on even the comparatively few other types of products, many of them less essential than cars and trucks, subjected to such a tax. This is shown by the fact that the five excises levied on cars and trucks and their operation—the present 1½-cent-a-gallon tax on gasoline, the 7-percent excise on automobiles, the 5-percent levy on automotive parts and accessories, the 5-percent levy on trucks and busses, and the 5-cents- and 9-cents-per-pound tax on tires and tubes—yield more than 82 percent of the total revenue obtained from current manufacturers' excise-tax levies. In dollars and cents, the automotive levies under the present law place an estimated $1,425,000,000 in the Treasury while the manufacturers' excises, applying to nonautomotive products, bring in a total of only $310,500,000.

Included in these nonautomotive products are the levies on electric, gas, and oil appliances, electrical energy, radios, and television sets, sporting goods, fountain pens and pencils, and photographic apparatus and films. Millions of other products are not subjected to 1 cent of excise tax.

Second, and this is particularly important, the House bill would make this present discrimination against the motorist and truck operator even far greater by increasing automotive excises so that they would yield an estimated $502,000,000 more annually than under current rates. At the same time, the House bill eliminates and reduces more levies on nonautomotive items than it increases. As a result of this reshuffling it actually lowers the over-all tax yield from nonautomotive items a total of $90,800,000. When this revenue loss in nonautomotive items is subtracted from substantial proposed increases in the automotive levies, the net gain to the Treasury will be $411,200,000. But the fact remains, Senators, that car and truck owners would be taxed an additional $502,000,000 to obtain the $411,200,000 gain.

I hasten to add that the automobile dealers of this country certainly do not object to the reduction in manufacturers' excises provided in the House bill on the nonautomotive products that have been taxed at varying rates. But, we do object, on behalf of the Nation's car buyers and owners, to increasing the obviously discriminatory excises against our customers. Maintaining automotive excises at current levies would simply continue the discriminatory taxing of two of our country's most essential and most tax-burdened products, the family car and the truck. Increasing these excises as provided in the House bill would compound an already grave injustice to the workingman and the farmer, in fact everyone who depends on his car or truck directly or indirectly for his livelihood.

The current automotive excises are already depriving many essential workers of dependable transportation. Increasing these excises would add materially to this number.

Moreover, past experience has proven that when taxes are increased, even though the increases are adopted as emergency and temporary measures, the tax increases long outlive the Congressmen who originally voted for them. This is a particularly serious matter when the product is also the main revenue producer for the States.

In addition, you gentlemen know even better than we do that when you tax a product and its use beyond the ability of the public to pay, you have also reached the point of diminishing returns from tax levies. Although wages are at high levels today, it is also true that many essential workers have fewer dollars for spending since both income tax rates and the prices of virtually all essential items, particularly food, have risen sharply. Depriving these large groups of the dependable cars and even necessary repair parts for their present vehicles through excessive taxation certainly will not add to Federal revenue, and at the same time will cut into the principal revenue of most, if not all, States.

The remarkable automotive development of this country in the past which accounts for the fact that with only 6 percent of the total world population today Americans own over 75 percent of the world's automobiles has been due to reasonable prices made possible by mass production. In our country the automobile has been placed within the reach of modest income groups. As I pointed out earlier, however, taxes have steadily been increased in recent years until today they take from 24 to 28 cents out of every automobile dollar and, in the case of gasoline, amount to about one-third of the retail price. If this dangerous trend is carried to excess, as the proposed tax increases would do, the purpose of automotive taxation will be defeated, production crippled, and the automobile returned to its early-day status as a product only for the wealthy. Let's take a lesson from Europe's unfortunate experience with excessive automotive and gasoline taxation and remove the burden of unjust, unreasonable automotive taxes from the Nation's workers and farmers.

It is gratifying to note that this Congress has been seeking ways and means to curtail Federal expenditures. We are specially interested and appreciative of your work in cutting nondefense spending.

We have also been impressed with the consideration this committee is giving to closing further loopholes in the present tax program. To us, the defense program is everybody's job. It is everybody's responsibility. To make it so, everyone should pay his share. To accomplish this, we would suggest that other sources of revenue be obtained from fields of business not now taxed.

Perhaps this committee will also find it expedient to give further consideration, as has been proposed by others appearing here, to some form of a general manufacturers' tax across the board. A tax of this type would prove, we feel, more equitable, fairer to everybody.

Such a tax might mean that it would be possible to reduce some of the more objectionable features of the proposed tax bill which you are considering. I refer specifically to the excess-profits tax and the increases on personal income.

Senators, let us always remember that there is a grave danger in going beyond, in taxation, what our private enterprise system can stand. Taxes can—and already are threatening to—destroy all initiative to produce.

No selected segments of American industry nor of the Nation's population should at any time—in an emergency or otherwise—be called upon to bear an inequitable share of the excise—or any—tax burden.

That applies with equal force to the excess-profits tax. Inequities in the present excess-profits tax law are working a serious hardship on thousands of businessmen, including many automobile dealers. In addition, even greater inequities and increased hardship would result from certain changes in the House bill, if it should be enacted into law. Naturally, as representatives of the Nation's enfranchised passenger car and truck dealers, we are seriously concerned and want to take this opportunity to endorse the testimony of representative automobile dealers, who have already testified before this committee. They have explained to you from their own experience the great need for equalizing the excess-profits-tax burden and removing its inequities so that all businessmen will be treated fairly.

As they explained, comparatively new corporations, both those which commenced business during the base period years and others launched since then, are placed under a severe and unfair tax handicap by the present law and by provisions of the House bill. We urgently recommend that you give the most careful consideration to these and other excess-profits tax inequities which representative member-dealers of our association presented to this committee. We will sincerely appreciate any corrective measures which this committee recommends that will remove these inequities and assure that the intent of Congress is followed in applying the excess-profits tax.

To summarize briefly, we have shown in our presentation on proposed automotive excise taxes:

First, that the average car buyer under present excise-tax rates is paying from 24 to 28 cents in taxes out of every automobile dollar expended.

Second, that the proposed increases in automotive excise taxes would add substantially to the inequitable and terrific tax load already heaped by the Federal Government, States, and even many cities on a highly essential product upon which the average worker and farmer must depend.

Third, that current automotive tax rates discriminate unfairly against the car or truck buyer also in that they far exceed in rate and yield similar manufacturers' excises on comparable products, many of them less essential.

Fourth, that the present discrimination against the car buyer would be made far greater under the House bill in that it would add one-half billion dollars to automotive excise levies while reducing the manufacturers' excise tax yield from nonautomotive items by more than $90,000,000.

Finally, we urge this committee to make whatever tax program it adopts temporary by stipulating a definite expiration date. On behalf of the Nation's workers and farmers, we further urge this committee to find a more equitable tax than automotive excises and to make sure that the already overburdened motorist is not saddled with additional excise taxes far out of proportion to his just share. We urge Congress to continue to curtail Government expenditures, to close loopholes in the present tax laws, and to protect the public's mobility by removing harsh and discriminatory taxes.

NADA breakdown of revenue changes under House bill

Manufacturers' excises	Tax base	Present rate	Rate under House bill	Estimated revenue [1]	
				Present law	Increase under House bill
Automotive excises:				*Millions*	*Millions*
Gasoline	Gallon	1½ cents	2 cents	$625.0	$208.8
Automobiles	Manufacturers price.	7 percent	10 percent [2]	415.0	174.2
Auto parts and accessories	do	5 percent	8 percent [3]	95.0	56.0
Trucks and busses	do	do	do	115.0	69.0
Tires and tubes	Pound	5 and 9 cents	No change [4]	175.0	−1.0
Increase					502.0
Nonautomotive excises:					
Electric, gas, and oil appliances.	Manufacturers price.	10 percent	No change [5]	75.0	17.9
Electrical energy	Charge	3⅓ percent	Repealed	103.0	−103.0
Fountain pens and pencils.	Manufacturers price.	No tax [6]	20 percent [6]	0	17.6
Radios and television sets.	do	10 percent	No change [7]	83.0	Negligible
Photographic apparatus and film.	do	25 and 15 percent	20 percent [8]	38.0	−22.0
Sporting goods	do	10 percent	15 percent [9]	[10] 11.5	[10] −1.3
Total, manufacturers excises.				1,735.5	411.2
Decrease					−90.8
Net increase					411.2

[1] Full year effect at estimated fiscal 1952 levels of income.
[2] Tax on house trailers retained at 7 percent of manufacturers' price.
[3] Credit or refund of tax granted for certain replacement parts if sold for use on farm equipment and tractors. Excludes from tax the fair market value of parts traded in for rebuilt parts.
[4] Exempts tires with internal wire fasteners and all-rubber tires if not more than 20 inches in diameter and 1¾ inches in cross section.
[5] Includes the following household types of appliances: Power lawn mowers, electric or gas clothes driers, and electric belt-driven fans, door chimes, dehumidifiers, dishwashers, floor polishers and waxers, food choppers and grinders, hedge trimmers, ice-cream freezers, mangles, motion-picture and slide projectors, pants pressers, and shavers. Exempts heating pads and includes electric sheets and spreads.
[6] Pens and pencils ornamented with precious metals are currently subject to the 20 percent retail tax on jewelry. Under the proposal they would continue to be taxed at the retail level.
[7] Exempts communication and navigation receivers of the type used in commercial, military, or marine installations when sold to the United States for its exclusive use.
[8] Exempts business type photographic apparatus and film.
[9] Exempts basketballs, boxing gloves and other boxing equipment, footballs and other football equipment, cricket balls and bats, fencing equipment, gymnasium equipment and apparatus, hockey equipment, lacrosse equipment, mass balls, push balls, skates, snow toboggans and sleds, soccer balls, soft balls and other softball equipment, track hurdles, vaulting equipment, volley balls and other volley ball equipment, water polo equipment, indoor baseballs and other indoor baseball equipment, and wrestling head harness.
[10] Excludes collections from the tax on fishing equipment.

Source: Secretary of the Treasury Snyder's presentation to the Senate Committee on Finance, June 28 1951.

Senator KERR. Our next witness is Mr. Charles Collins.

STATEMENT OF CHARLES COLLINS, GENERAL COUNSEL, AMERICAN AUTOMOBILE ASSOCIATION

Mr. COLLINS. Mr. Chairman, my name is Charles Collins, and I appear as general counsel for the American Automobile Association, which is a Nation-wide federation of automobile clubs with a membership of more than 3,300,000.

We have prepared a detailed statement in opposition to certain of the Treasury's excise-tax proposals, which I would like to offer for the record. In the next few minutes, however, I will present a summary of our position.

Because the American Automobile Association is a consumer organization, representing the interests of all passenger-car owners, we must oppose these two proposals of the Treasury Department:

1. To increase the Federal excise tax on gasoline from 1½ to 3 cents per gallon;

2. To increase the Federal excise tax on new automobiles from the present 7 to 20 percent.

We strongly believe that enactment of these two proposals would not be in the public interest, for three major reasons: First, they place an unduly heavy burden on the automobile which is an essential and not a luxury; second, they would visit hardship on low-income groups dependent on the passenger car for transportation; and third, they would constitute a further serious invasion of the motor vehicle tax field by the Federal Government.

The American Automobile Association has always been opposed to the principle of Federal automotive excise taxation and our representatives have made this position clear to the Congress over the years. However, we have also recognized the enormous revenue problems faced by the Congress and because of these problems we suspended our opposition during World War II.

However, the motoring public today is being taxed to the hilt. In 1949 alone, the total of all road-user taxes paid into Federal, State, and local governments amounted to almost $4 billion. As if that were not enough, the motorist would bring the total road-user tax bill to the staggering sum of $5,600,000,000, and this is shown by chart B attached to our statement.

Senator KERR. Can you tell the committee the total amount spent on roads by the States and local communities and the Federal Government?

Mr. COLLINS. I believe that—no, I cannot give you that figure. I can give you the Federal Government figure which shows about half a billion dollars, sir.

Senator KERR. Well, the total amount is less than this figure by a good deal.

Mr. COLLINS. That may be true, sir, but we take the position that the amount that the Federal Government spends for the roads, comes from the general tax funds and has no relationship to the gasoline tax.

Senator KERR. I understand, but just as a matter of, perhaps, my academic curiosity, I wondered whether you knew that.

Mr. COLLINS. I know the Federal figure, but I cannot give you the State figure.

Senator KERR. You do not have that?

Mr. COLLINS. No, sir; I do not have that. As a matter of fact, the motorist is being asked to carry more than 40 percent of the entire proposed excise increase of $3,035,000,000. And why? Because, as Secretary Snyder stated to the House Ways and Means Committee:

The taxes on tobacco, liquor, and gasoline are the most productive of our excises. These items provide the basis for substantial additional revenue.

Significantly, Mr. Snyder did not put the matter so bluntly when he appeared before this Senate committee, but he did propose the same measure of increase in these taxes and failed to justify them on any other grounds. The American Automobile Association cannot agree with the Treasury Department that just because a tax is already costing the motoring public dearly, there is any sound justification to increase it still further.

This is a good time to remember that during World War II, 77 percent of all automobile trips were for essential purposes and that 95 percent of all passenger cars were used wholly or partly for essential purposes. A study of 749 war plants showed that 75 percent of the employees went to and from work in automobiles. And at aircraft plants, navy yards, and tank factories, the figure was upward of 90 percent.

Now, gentlemen, the essentiality of the passenger car has greatly increased since then. In the past 5 years, car ownership has risen from 25,700,000 to 40,000,000. But more important, the great population growth of the last decade has been primarily in suburban areas. This, with the accompanying decentralization of industry, particularly defense industry, has created a condition of extreme dependence on passenger cars as a transportation medium. That is why we insist the passenger car cannot be classified as a nonessential item.

We are also convinced the burden of the excise would be borne by low-income groups; for, according to the Federal Reserve Board, 59 percent of all passenger cars are owned by families or individuals earning less than $4,000 annually, while only 9 percent are owned by those earning over $7,500, and there is a chart attached to our long statement which will give the committee those figures.

In evaluating the burden on the low-income groups, there is a circumstance which your committee would do well to keep in mind; because of the gap in production during the last war, the persons who normally would buy used cars, 5 to 8 years old, are being forced into the higher-priced used- and new-car market.

In addition, the increased gasoline tax would create a distinct hardship on this income group, since its burden would be imposed on motorists without any consideration for their ability to pay.

Further, we oppose the automotive excise program because it would all but preclude the raising of additional badly needed highway funds by the States, which now get about $3,000,000,000 in road-user taxes—as compared with the $2,600,000,000 which the Federal Government would get under the Treasury proposal.

These taxes would have the definite effect of raising the average American's cost of living, nor could it be otherwise when the tax on a new car is raised from $100 to $300 and the tax on gasoline is boosted 1½ cents per gallon.

Senator KERR. Would you wait right there a minute, please?

Mr. COLLINS. Yes, sir.

Senator KERR. The figures here would show that with this new tax total that they pay, the motorists pay to the States and Federal Government, would be $5.6 billion.

Mr. COLLINS. If the Senator will refer to our chart B on the long statement, it is the next to the last page, you will find that a chart——

Senator KERR. I did not misquote your statement, then, did I?

Mr. COLLINS. No, sir. You will find a chart which will set that forth, sir.

Senator KERR. Didn't you just set it forth in what you have just read?

Mr. COLLINS. I think so; yes, sir.

Senator KERR. What I was wondering about was the figure on page 2 where you said that——

Senator TAFT. $5.6 billion.

Senator MARTIN. Mr. Chairman, may I ask Mr. Collins—you state the boost in gasoline is 1½ cents. Do you have any idea what the boost is in the average on the State level?

Mr. COLLINS. No; I do not believe I can answer that, either, sir.

Senator KERR. The present State level is given in that exhibit of Mr. Freed's statement, Senator—wait a minute, it is right here in this pamphlet of this committee.

Senator MARTIN. What I wanted to get was the increase by the States, we will say, in the last couple of years, because a good many States have also increased the gasoline tax.

Mr. COLLINS. Well, Senator, may I be permitted to furnish that, too? Let me see if I understand you correctly. You would like to know the actual amount of increase of the gasoline tax in the various States last——

Senator MARTIN. Maybe we have it here. I guess we do have it here, so you need not bother about it. We have a table showing that.

Mr. COLLINS. Thank you, sir.

Senator MARTIN. Yes; thank you.

Mr. COLLINS. Is there anything else, Senator Kerr?

Senator KERR. No, sir.

Mr. COLLINS. May I conclude then?

Mr. Chairman, in conclusion, the American Automobile Association reiterates its policy of opposition to Federal automotive excise taxes as a method of raising revenue in normal times. This source of revenue should be left to the States.

2. The association wishes to compliment the House Ways and Means Committee for its refusal to go along with the proposals of the Treasury Department, but it is our feeling that even the amount of increase approved by the House committee is unwarranted under existing conditions, especially in view of the latest figures on tax returns, which show that the Government is in a much better position than was anticipated when these proposals were first submitted by the Treasury.

3. In conclusion, I wish to state that the association strongly opposes any increase whatever in present rates of Federal automotive taxes.

Senator BYRD. Thank you, Mr. Collins.

(The prepared paper of Mr. Collins is as follows:)

STATEMENT BY CHARLES C. COLLINS, GENERAL COUNSEL, AMERICAN AUTOMOBILE ASSOCIATION

Mr. Chairman, I should first like to express our very real appreciation for the courtesy you have shown us in arranging this opportunity to appear before your honorable committee to discuss certain aspects of the Treasury's proposal relating to the Federal excise-tax schedule.

The American Automobile Association is a federation of motor clubs having at the present time a total of over 3,300,000 members. It is our earnest endeavor at all times to represent the interests not only of our own membership, but the interests of all passenger-car owners. Because we are essentially a consumer organization, our interest is primarily in the people who must pay these taxes.

The American Automobile Association is vitally interested in two phases of the Treasury's excise-tax proposals: First, the proposed increase in the Federal excise tax on gasoline from 1½ cents per gallon to 3 cents per gallon; and, second, the proposed increase in the Federal excise tax on new automobiles from the present 7 percent to 20 percent.

We consider these proposals to be against public interest for three major reasons: (1) They place an unduly heavy burden on the automobile, which is an essential and not a luxury; (2) they would visit hardship on low-income groups dependent on the passenger car for transportation; and (3) they would constitute a further serious invasion of the motor-vehicle-tax field by the Federal Government.

Federal automotive excise taxes are not wartime taxes. They have been imposed since 1932. The present levels were established as a part of revenue measures enacted in 1940 and 1941 to finance the all-out national war effort. They have remained unchanged since that time, even though the war ended in 1945.

The position of the American Automobile Association is a historical one in opposition to Federal automotive excise taxes. Representatives of our organization have appeared before committees of the Congress on a number of occasions over a period of many years and presented statements setting forth the policies of the American Automobile Association.

We have tried to take into consideration the enormous revenue problems faced by the Congress. This is evidenced, I believe, by the fact that, when it was necessary on account of World War II to increase automotive excise taxes, we voiced no opposition. However, today the situation is different.

At the present time, Federal automotive tax rates are as follows: Passenger automobiles, 7 percent of manufacturers' price; trucks and busses, 5 percent of manufacturers' price; parts and accessories, 5 percent of manufacturers' price; gasoline, 1½ cents per gallon; lubricating oils, 6 cents per gallon; tires, 5 cents per pound; and tubes, 9 cents per pound.

Collections from these various levies in 1949 amounted to: Automobiles, $448,-100,000; trucks and busses, $111,700,000; parts and accessories, $93,300,000; gasoline, $469,500,000; oil, $39,100,000; and tires and tubes, $142,800,000; for a total of $1,304,500,000 (see chart A).

EFFECT OF THE TREASURY'S PROPOSALS

One can only conclude that the Treasury Department has singled out the motorist as target A in its new excise-tax proposals. The entire schedule of proposed excise increases would bring in an estimated $3,035,000,000 in additional revenue and the $1,265,000,000 share assessed vehicle owners would represent more than 40 percent of the entire increase.

The fact that many other items in the excise-tax structure remain unchanged, some of them clearly less essential than the automobile, is in itself the strongest possible evidence of discrimination against the motorist.

Secretary Snyder stated to the House Ways and Means Committee, "The taxes on tobacco, liquor, and gasoline are the most productive of our excises. These items provide the basis for substantial additional revenue." Significantly, Mr. Snyder did not put the matter so bluntly when he appeared before this Senate committee, but he did propose the same measure of increase in these taxes and failed to justify them on any other grounds. The American Automobile Association cannot agree with the Treasury Department that just because a tax is already costing the motoring public dearly, there is any sound justification to increase it still further.

The proposals also appear to overlook the fact that motor-vehicle owners already are heavily taxed by other units of Government. In 1949, the total of all road-user taxes paid into Federal, State, and local governments, plus the amounts paid into toll-road turnstiles, amounted to almost $4 billion. We have estimated that the new schedule if adopted would bring the total road-users tax bill, Federal, State, and local, to the staggering sum of $5,600,000,000. The picture appears in chart B.

ESSENTIALITY OF THE PASSENGER CAR IS DISREGARDED

These proposals ignore the fact that transportation, as provided by the private passenger car, has reached a level of essentiality to the large majority of American families approaching that of such well-recognized needs as food, housing, and clothing. Discriminatory taxation is always undesirable, but when it affects the necessities of life, it strikes at the very foundation of our way of living.

The suggested program ignores the fact that the weight of the tax would fall most heavily on lower-income groups who are dependent on the passenger car and who can ill afford a further increase in their transportation or any other costs.

From the standpoint of both current and future Federal taxation, the most disturbing feature of the new tax proposals is that the Treasury Department apparently considers the private passenger car as a luxury or a nonessential which, along with tobacco and liquor, can be heavily taxed as a continuing source of Government revenue. It is our considered opinion, and we hope your committee will agree with us, that this thinking is not only unrealistic, but is fraught with the greatest danger to the future of highway transportation in the United States.

Aside from the long-range viewpoint, this line of thinking could very well defeat the mobilization effort itself because the passenger car is an essential tool in this Nation's productive effort.

In addition, it is all too similar to the thinking that so nearly caused disaster during World War II. Typical was the viewpoint of the then Administrator of the Office of Price Administration, who took the position that 20,000,000 of the Nation's then 27,000,000 passenger cars could well go off the road. It eventually developed that 25,400,000 passenger cars had to be kept in operation to prevent a transportation breakdown and the resultant collapse of the war effort. The Administrator of OPA, at a later date, was frank enough to state to a Senate committee:

"The reliance on the automobile or rubber-borne transportation is considerably more than even the loftiest statement made by the industries connected with the making of automobiles and tires, and of the various associations like the great AAA and their State organizations. In other words, what might seem to have been a matter of trade booming as to the importance of automobiles by interested trade associations or business was a considerable understatement, as we have come to know."

This is a good time to remember that during World War II an automobile manufacturers association survey revealed that 55 percent of passenger-car mileage was for essential purposes; 77 percent of the trips were for essential purposes and 95 percent of all passenger cars were used partly or wholly for essential purposes. War workers were particularly dependent on passenger cars; a study of 749 war plants revealed that 75 percent of the employees went to and from work in automobiles. In aircraft plants, navy yards, and tank factories upward of 90 percent of all employees drove to work.

Now, gentlemen, the essentiality of the private passenger car has very greatly increased since World War II. Car ownership has risen from 25,700,000 to 40,000,000. Even in cities, three-fourths of all vehicular travel is done by private automobiles. There are 2,074 United States cities having no public transit systems. Even where there are such facilities, they are operating near capacity.

There has been a tremendous growth in population during the past decade: from 130,000,000 to 150,000,000. Most of this growth has taken place in suburban areas. While population in central cities increased 13 percent during the 10-year period, population in the suburbs soared 35 percent. This migration of families to the suburbs together with decentralization of industry, particularly defense industry, has greatly increased dependence on passenger cars as a vital transportation medium.

HARDSHIP ON LOW-INCOME FAMILIES

These tax proposals appear to be based on the premise that the weight of these taxes would rest largely on the upper income groups. As a matter of fact, a recent study by the Federal Reserve Board showed that 59 percent of the cars in operation were owned by families or individuals ("spending units" in the Board's terminology) earning less than $4,000 a year. Only 9 percent of the cars were found to be owned by units making $7,500 and over. Chart C attached presents a breakdown of car ownership by income groups.

The increased tax on new cars would impose a more-than-normal hardship on the lower-income groups at the present time. The suspension of passenger-car production during the 4-year period beginning in 1942 caused a gap in the supply of good and moderately priced used cars on which industrial workers, farmers, and others in need of economical transportation generally depend for their essential transportation needs. The continued strong demand for new cars during the past 2 years indicates that, because of the lack of used cars in the 5- to 8-year-age bracket, many buyers normally purchasing used cars have been virtually forced into the new car market. The increased gasoline tax would be highly regressive in that its burden would be distributed among all income groups and related to the amount of necessary driving done rather than to ability to pay.

EFFECT ON STATE HIGHWAY FINANCES

The states now levy road user taxes in the amount of about $2,100,000,000 annually. The proposed increase in Federal automotive excise tax would bring the Federal levy on the highway user to a total of $2,600,000,000 annually. This represents an invasion of the States' principal source of highway funds so substantial as to all but preclude the raising of additional badly needed highway funds at the State level.

EFFECT ON COST OF LIVING

The Treasury Department, in its proposal, said the suggested taxes "will not add much to business costs or push up the cost of living materially."

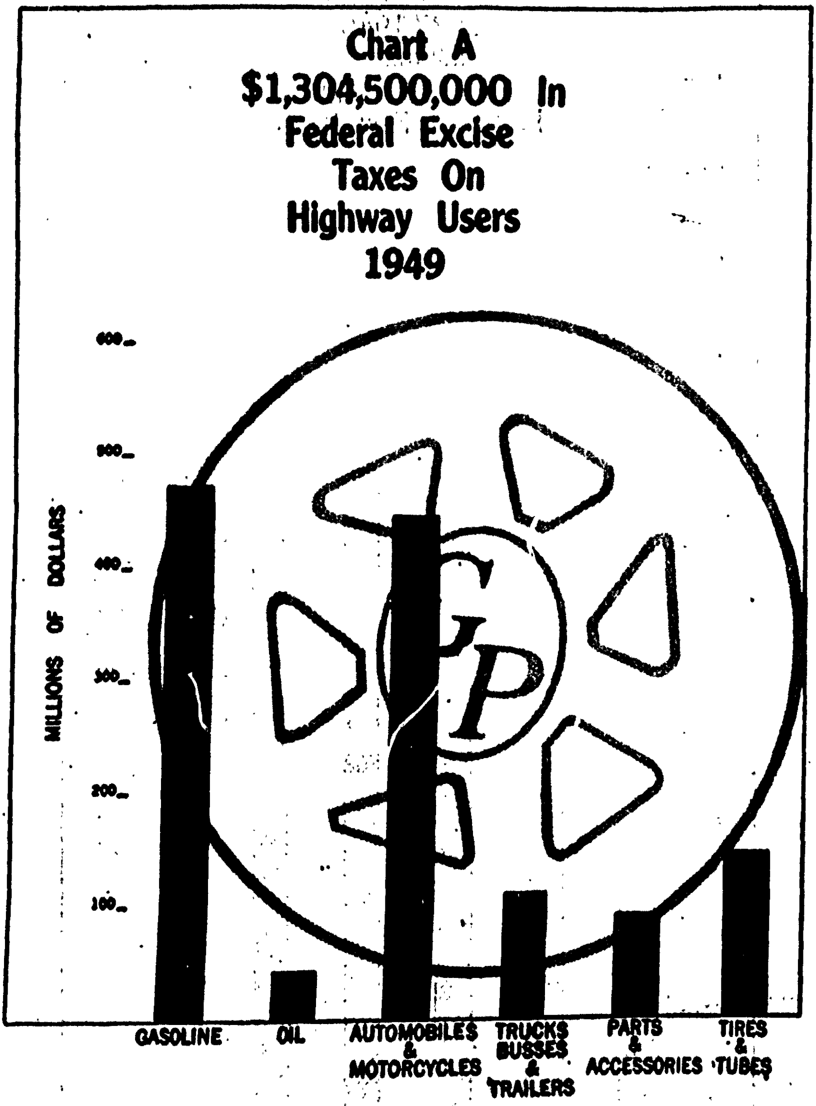
The facts are that Federal taxes on both gasoline and passenger cars are passed on to the consumer. The Federal tax on an automobile cannot be raised from about $100 to $300 without exerting pressure on the sales price, nor can it be assumed that a 1½-cent increase in the tax on gasoline will be absorbed by anyone except the ultimate purchaser. Transportation already is a major item in the average family's budget and the Treasury's proposals would unquestionably result in greatly increased costs of car ownership and operation.

CONCLUSION

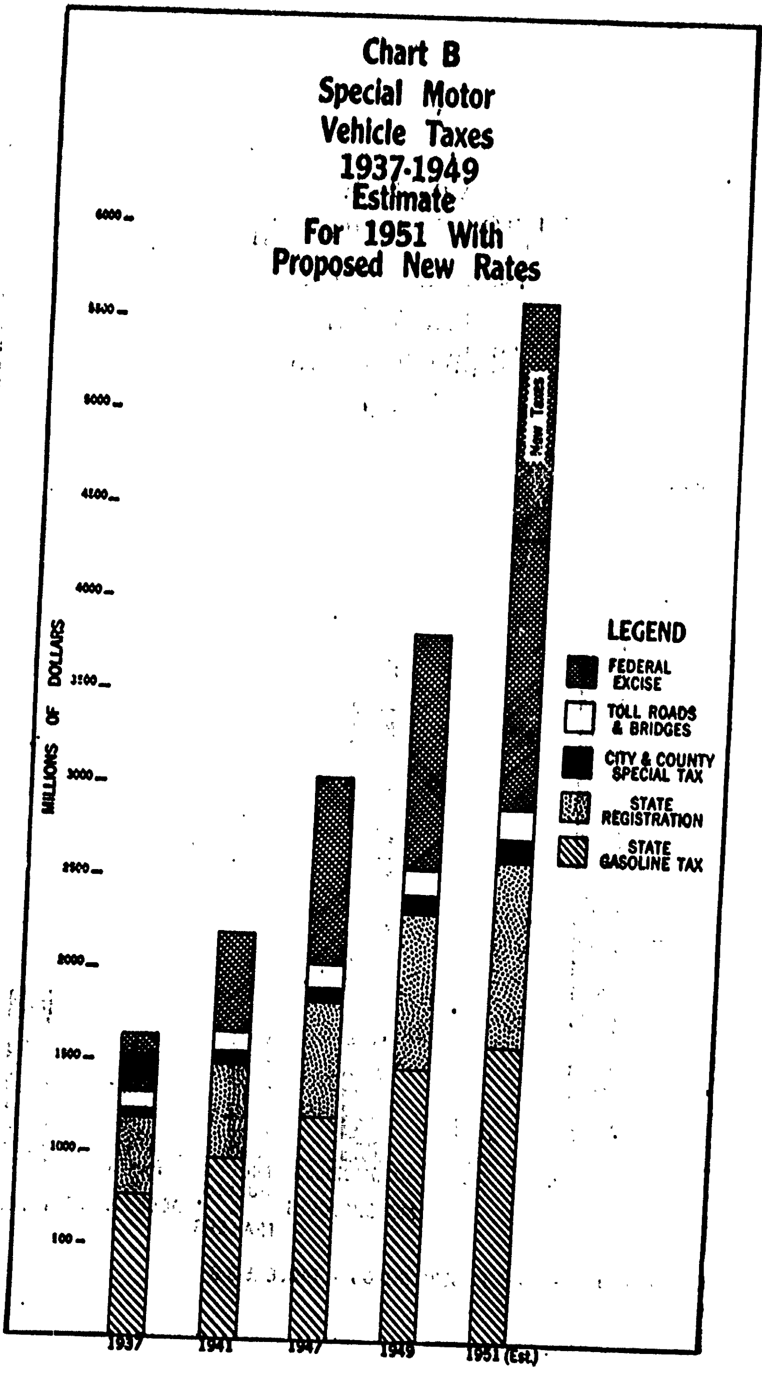
1. The American Automobile Association reiterates its policy of opposition to the Federal automotive excise taxes as a method of raising revenue, except in most unusual circumstances. This source of revenue should be left to the States.

2. The association wishes to compliment the House Ways and Means Committee for its refusal to go along with the proposals of the Treasury Department, but it is our feeling that even the amount of increase approved by the House committee is unwarranted under existing conditions, especially in view of the latest figures on tax returns, which show that the Government is in a much better position than was anticipated when these proposals were first submitted by the Treasury.

3. The association is strongly opposed to any increase whatever in the present rates of Federal automotive taxes because (a) a disproportionate share of the increased excise burden would be placed on the private passenger car which is an indispensable necessity and not a luxury; (b) hardship would be visited on car owners in the lower-income groups; (c) State highway financing programs would be disrupted; (d) the effect would be to further increase the cost of living.



SOURCE · U.S. BUREAU OF PUBLIC ROADS · TABLE E-3-B



SOURCE - U.S. BUREAU OF PUBLIC ROADS (1937-1949) 1951 ESTIMATED BY AAA

CHART C.—*1949 car ownership by income groups*

[59 percent of United States cars owned by people earning less than $4,000 per year]

Income per year—	*Percent of cars*
Under $1,000	5
$1,000 to $1,999	11
$2,000 to $2,999	19
$3,000 to $3,999	24
$4,000 to $4,999	16
$5,000 to $7,499	16
$7,500 and over	9
Total	100

Source: Based on 1950 survey of consumer finances conducted by the Reserve Board.

Senator BYRD. Mr. Barit.

STATEMENT OF A. E. BARIT, CHAIRMAN, TAXATION COMMITTEE, AUTOMOBILE MANUFACTURERS ASSOCIATION, ACCOMPANIED BY HARLAN V. HADLEY, SECRETARY, AUTOMOBILE MANUFACTURERS ASSOCIATION

Mr. BARIT. Mr. Chairman, and members of the committee, my name is A. Edward Barit.

I am president of the Hudson Motor Car Co. I appear here today before you in my capacity as chairman of the taxation committee of the Automobile Manufacturers Association.

We have filed a brief with you, and in order to conserve your time, I plan to read only parts of it, and I beg your indulgence long enough to give you a little of the thinking which led up to the conclusions that are contained in this brief.

Senator BYRD. Yes, sir; go right ahead.

Mr. BARIT. With your permission, Mr. Chairman, I would like to finish my testimony before I am questioned.

Senator BYRD. Very good.

Mr. BARIT. The automotive industry is profoundly disturbed by some of the glaring inequities of the pending revenue bill as adopted by the House.

It is particularly disturbed because that bill widens instead of equalizing existing excise taxation discriminations among goods which compete for the consumers' favor.

Our industry—and I am sure you know we have 912,000 employees and 45,000 dealers—is perfectly willing to pay its fair share of any taxes that may be necessary, after nondefense and nonessential Government expenditures are cut to minimum levels to meet the higher governmental costs resulting from the defense effort.

Our "fair share" it seems to us in the automobile industry, should be defined as the result of the application of a uniform excise tax rate to all manufactured end products except food and shelter.

Further, we think that such taxes should be levied only for the period of the emergency, and that they should carry an automatic termination clause.

As producers of automobiles and as American citizens we would fail in our duty if we did not call your attention to the tremendous burden of taxation already imposed upon automotive products at the present time, with the excise tax rate on passenger cars 7 percent, the total tax burden amounts to 29 percent of the total price of the automobile.

Taxes of all kinds—Federal, State, and local—amount to $584 of the $2,000 total price of a typical new lower-priced car.

Discriminatory taxes limit free choice. In view of the tremendous burden of over-all taxation now being carried by our people, the matter of public preference as to method of taxation becomes more than usually important.

Consequently, we desire to register our belief that the majority of the people would prefer the general excise tax—except on foods and shelter—to the present method of applying excise taxes only to a selected list of articles.

The reason for our belief is that the general excise tax plan would tend to minimize the tax on each individual article, and to thus avoid a prohibitively high tax on any particular item.

Few things could irritate a taxpayer more than to learn that the very thing he wants to purchase carries a disproportionate excise levy—perhaps beyond his ability to pay. We are sure he would much rather we spread the total excise take over all articles so that it would not put any particular article beyond his reach.

He could then choose between the various articles he might like to buy.

As you probably know, there are 40 million people in this country who are interested in what happens to the price of automobiles; there are that many cars now registered.

If I may give you a little of the thinking back of that, we know that there is opposition in some congressional circles to the general tax plan, and we feel that if the original concept of that plan was reviewed in the light of events which have occurred since that day, it would result in a change of attitude, we know that the original attitude toward the plan was prompted by a desire to help low-income people and to, perhaps, make the over-all tax bill more palatable to the masses.

But, gentlemen, think of the tremendous changes that have occurred since that day. A great many of the very people whom you sought to protect are today feeling seriously the pinch of excise taxes.

Think of the fact that the distribution of automobiles has broadened tremendously. Today you find automobile owners in practically every income bracket, and I dare say that in the lower-income brackets you will find a larger percentage of the people are absolutely dependent upon the private car for transportation to their jobs.

Gentlemen, it has been the policy of the Nation to foster a high standard of living, to encourage volume production; as a result, the people in practically all walks of life aspire to the ownership of the automobile, and of the things which carry heavy excise taxes today.

Those people who cannot afford those articles are taken care of in the concept of the general excise tax plan by the elimination of food and shelter, which certainly represents the great majority of their purchases.

Now, another thing, it seems to me, to consider is the fact that the excise tax, which used to be very small in amount, has grown to very large proportions.

I wonder if you realize that if the 10-percent tax contained in the House bill becomes law, it will mean that the prospective purchaser of an automobile will be required to pay, if he wants a car in the lowest-price field, about $140 in excise tax alone, and in the medium-priced class, $225, and, of course, in addition to that, there are numerous, innumerable, taxes that find their way into the price of an automobile, and the total of those taxes under the 7-percent tax for excise represents about 20 percent of the total purchase price of the average car.

Gentlemen, when you touch the selling price of an automobile, you touch the pocketbook of a great percentage of the people, and when you touch the selling price of trucks and refrigerators and the few other articles that today carry excise taxes, you touch the pocketbook of many more—I dare say, a great majority of the people.

Now, you can picture the dissatisfaction that enters the mind of the prospective purchaser of a car when he finds that he must pay such a disproportionate share of the excise tax when he attempts to purchase what to him is a necessity.

His dissatisfaction is very little relieved if you tell him there is no tax on a great many other things that he does not care to buy.

I am sure, under those circumstances, he would vote very readily for a plan which would tax a great many articles a little, rather than a few popular articles a lot.

I thought I would read a little history on the subject, and I consulted, among other things, the Encyclopedia Britannica, which work, as you know, attempts to record the human reactions to this and that through the ages.

Senator KERR. You will not attempt to quote it verbatim for the record?

Mr. BARIT. These pages are very short, Senator, and I think they are enlightening and I think might be of interest to the committee, if I have your permission to read them.

Listen to what they say under "Excise taxes," and now I quote:

> This form of taxation interferes so directly with the industry and liberty of the subject that it has seldom been introduced save in some prime financial exigency and has seldom been borne, even after long usage, with less than the ordinary impatience of taxation.

Now, listen to this from the pen of an eminent economist, Dr. A. T. Hadley, who, as you know, was president of Yale University at the turn of the century.

This is very brief:

> Excises or internal-revenue charges, when fixed at small amounts are often hardly distinguishable from fees. When they are large in amount they constitute a tax on the consumers of the articles so obvious as to be quite unpopular.

Now, gentlemen, it would appear from that that excise taxes through the years have been more unpopular than other types of taxes, and if you can get anything from this history, it would appear to be the part of wisdom to keep the excise tax on any particular articles as low as possible.

Now, to resume the brief: Automobiles are an essential in war as in peace.

This tax burden becomes very important when you consider the essentiality of motor vehicles. Surveys repeatedly have shown that more than half of all passenger-car mileage is necessary, with 77 percent of all trips connected with earning a living or other economic activity, and with 95 percent of the Nation's 40,000,000 passenger cars used wholly or partly for essential purposes.

This is one small facet of the story of the essentiality of the passenger car, contained in the document, Automobiles and National Defense, which we offer as part of our brief.

Gentlemen, I might say there parenthetically that we have gathered together a great deal of information, some of it in chart form, that I think would interest you. They are contained in the booklets which are attached to our brief.

We give such interesting information as the essentiality of the car to the individual by States. We think you will find them interesting and if there is any other datum that you desire, we should be happy to see that it is at your disposal.

Few persons realize that motortrucks carry three times as much freight as the combined total hauled by all other forms of transportation.

This is one of the interesting facts contained in the document, Motor Trucks and National Defense, which we offer as part of our brief.

Thus, these taxes on automotive products represent a levy on instrumentalities essential to the economic life of the people, clearly essential to the economy in war as well as in peace.

Further, in the case of the tax on replacement parts, which the House bill would raise to 8 percent from 5 percent, the excise is a tax on misfortune. Today's average car is nearly 8 years old, against a prewar average of 5.5 years.

When you remember that most old cars are owned by people in lower income brackets, the inequity of this tax becomes apparent.

I might add, again parenthetically, another point to remember in this connection is that the current restriction being placed on automobile buying of cars will have again to be used beyond the average age. It will mean more frequent repair bills, more emergency repairs, and this tax will make it even more difficult for those who have no other way of helping themselves.

The congressional committees have agreed from time to time that automobile taxes are unfair. They recognize them as temporary or emergency measures, and agree that they should be eliminated as early as possible.

In our appearance earlier this year before the House Ways and Means Committee, no mention was made of the effect on the Nation's 8,600,000 truck owners of the proposed increases in automotive excises for the reason that no proposal existed at that time for increasing the Federal tax on trucks.

In view of the intent of the House to increase truck excise taxes by 60 percent, or to 8 percent from 5 percent, we believe your committee should consider the following facts:

1. Recognizing that trucks are essential in the defense production, the Defense Production Administration has authorized almost maximum truck production.

Senator KERR. I wonder if you would be offended if I interrupted you, although I recognize you asked not to be interrupted until you concluded?

Mr. BARIT. Senator, I would be very happy to have you do so.

Senator KERR. I read on page 8 where you give the number of passenger cars at 40 million.

Mr. BARIT. Yes, sir.

Senator KERR. As of what date was that?

Mr. BARIT. As of the end of 1950. There were that many registered; and trucks, 8,000,000.

Senator KERR. 8,000,000 trucks?

Mr. BARIT. Yes, sir.

Senator KERR. Then my "guesstimate" of a while ago of the number of passenger cars and trucks as of today being in excess of 50 million would not be too far off?

Mr. BARIT. It was quite correct.

Senator KERR. Thank you, sir.

The 40 million was accurate but for passenger cars.

Mr. BARIT. For passenger cars; yes, sir.

Senator KERR. It doesn't include trucks?

Mr. BARIT. And since then that has probably been increased. That was at the end of 1950.

Senator KERR. Haven't there been about 3 million units manufactured since then?

Mr. BARIT. A little more than that.

Senator KERR. A little more than that?

Mr. BARIT. Yes, sir.

(2) As pointed out in the booklet, Motor Trucks and National Defense, appended, the Nation's trucking services are essentially unlike the services other freight haulers render, and these services are necessary, not only to defense production, but also to the efficient operation of all other freight carriers.

(3) Most trucks are owned by individuals, or by small-business firms, so that discriminatory taxes on trucks are a direct burden on small operators.

Senator KERR. May I interrupt right there?

This figure does not include the tractors?

Mr. BARIT. No, sir; it does not.

Senator KERR. Can you tell us approximately what that is, or is that further?

Mr. BARIT. I think you may find that in the charts in that booklet. Can you tell me, Mr. Hadley?

Mr. HADLEY. Our figures do not show the tractors.

Senator KERR. Do you have an estimate?

Mr. HADLEY. No, sir; we do not.

Mr. BARIT. We could get that, could we not?

Mr. HADLEY. By contacting the tractor industry, sir.

Mr. BARIT. If you would like to have us do that, we will do it.

Senator KERR. Yes, sir.

Mr. BARIT. Will you do that, Mr. Hadley?

Mr. HADLEY. Yes, sir.

(The information referred to follows:)

AUTOMOBILE MANUFACTURERS ASSOCIATION,
Washington, D. C., *August 1, 1951.*

Hon. ROBERT S. KERR,
United States Senate, Washington, D. C.

DEAR SENATOR KERR: Yesterday during Mr. Barit's testimony before the Senate Finance Committee, you asked him to obtain the figures on the number of tractors in use in the United States.

A careful check of pertinent sources inside and outside Government discloses that there are no reliable statistics on this product.

However, one source in the Department of Agriculture unofficially estimates that there are roughly 5,000,000 tractors in use in the United States, as of January 1, last. This figure was represented to us as being as accurate as could be obtained. I hope this answer is satisfactory.

Sincerely yours,

HARLAN V. HADLEY,
Secretary, Committee on Taxation.

Mr. BARIT. Farmers, for example, are the Nation's largest class of truck owners; they have more than doubled their use of trucks in the last decade in their production and marketing operations. Approximately 3 million trucks are used by farmers.

(4) No other vehicle for freight transportation, and no other tool of production or marketing, bears any Federal excise tax. Since the truck must be classed with farm tractors, industrial machine tools, and similar tools necessary to farm and factory production for military and vital civilian purposes, a special tax on trucks appears justified only under a general manufacturers' excise levy for emergency revenue.

In previous appearances before, and statements filed with, the Senate and House committees engaged in writing tax legislation, we have repeatedly opposed the existing structure of automotive excise taxes, for the reasons that:

1. They impede commerce by increasing the cost of moving goods and people;
2. They are increasing threats to production and employment in the motor-vehicle industry and in supplying industries;
3. They are taxes that affect lower-income groups relatively more than other income groups;
4. They are discriminatory, since they are not imposed on competitive forms of transportation, on other goods which compete with motor vehicle sales, or on other productive equipment;
5. They are unfair, as they place a relatively greater tax on farmers, small-town people, and others who necessarily depend mainly or solely on automotive transportation;
6. They are an extreme example of multiple taxation.

By ending these taxes with the end of the emergency, purchasing power would be increased, demand for consumer goods would be increased, production and employment would be increased and a solid base would be provided for a strong postemergency economy.

The automobile industry is particularly conscious of its actual and potential impact on commerce and industry generally, as one of every seven persons normally employed in the United States earns his living from the production, distribution, service, or use of the passenger car, truck, and bus.

It seems clear that excessive taxation on passenger cars and trucks, busses, replacement parts, tires and tubes, gasoline, and oil not only weakens the mobility of the people, which is one of the basic advantages we have over most other of the world's people, but it also tends to defeat its purpose.

This is because it tends to limit the use of an instrumentality which in itself generates activities which create income and provide wider sources for tax revenue.

Despite our willingness to support a general manufacturers' excise tax for the emergency period, the automotive industry would like to go on record to make it clear that it continues to oppose the discriminations and inequities of the present excise taxes.

The arguments we have advanced for repeal of existing emergency and temporary taxes on cars and trucks, on repair parts and accessories, on tires and tubes, and on gasoline and oil, have never been successfully challenged. We believe they are beyond challenge.

Now, gentlemen, in conclusion——

Senator MARTIN. Mr. Chairman, I just want to suggest that we have other witnesses coming, and while this is all very interesting, it is kind of unfair to men who have come a long distance, and we are getting limited as to time.

Mr. BARIT. If I may have 2 minutes more, I will be through.

Senator BYRD. All right.

Mr. BARIT. May I remind you that our people have been asked, as the people of the country have been asked, to accept sacrifices with a view to stemming inflationary tendencies, and I believe that people are apt to take their cue from you.

If through raising excise taxes you show not too much concern about rising selling prices, we can hardly expect the maximum effort on the part of people who supply material and labor that go into manufactured articles to accept sacrifices in the interests of selling prices.

Senator BYRD. Mr. Barit, I would like to ask you this question: You have got three increases in excise taxes here, in addition to the tax on gasoline. One increases the tax from 7 to 10 percent on passenger cars and motorcycles, and another is an increase in the tax on trucks from 5 to 8 percent, and another is an increase in the tax of automotive parts and accessories from 5 to 8 percent.

Which of those would you say was the most objectionable?

Mr. BARIT. Well, Senator, it is difficult to distinguish between them. They all represent an extreme burden and, I think, if I may suggest, with all humility, that that example illustrates as well as anything can, the extremely difficult situation that we have gotten into in this country from the standpoint of taxes.

There is almost no phase of it that you can touch but that it demonstrates very forcibly the extreme burden of taxation that our people are laboring with.

Senator BYRD. Of course, we are scraping the bottom of the barrel right now in all these taxes, we realize that.

Mr. BARIT. Senator, we did that sometime back, and yet we have——

Senator BYRD. This is scraping it a little further, we are getting into the bone and muscle of the business, we know that.

Mr. BARIT. Yes; and I think, as the result of that, we are bringing about a very serious situation.

I know a question has been raised here this morning about the impact on the lower-income group concerning this general excise-tax plan.

But, gentlemen, I think that it would be even more unfair to the people in the lower-income groups if through unwise taxation we weakened the economy and made it difficult for them to get jobs.

Senator BYRD. You would regard any of these three as being equally objectionable?

Mr. BARIT. I think they are all about objectionable——

Senator BYRD. In the same class, but are they more objectionable or less objectionable than the increase in the gasoline tax?

Mr. BARIT. Well, there again we have an extraordinarily high levy on gasoline and oil, and I feel that by going to a general levy we can perhaps relieve the situation in all of those cases, have——

Senator BYRD. A general levy is very difficult under this bill, as you know. It would take a long investigation, a long study, if we went into a general levy, and we would have to change drastically this present bill, that is, this excise part of it, I imagine.

Mr. BARIT. I am sorry to hear that. I was not aware of it.

Senator BYRD. Well, that is just my personal opinion. I may be wrong about it, but a general levy would certainly drastically change the whole tax structure of this bill as applied to excise taxes. It was not adopted by the House, and, therefore, this committee would have to go into long hearings on it.

Mr. BARIT. Of course, you may feel that through my ignorance I speak freely, but I feel so strongly about this particular situation with regard to these taxes that I would say that a delay in the tax bill would be warranted if it would result in a lessening of the levies on these individual items that we speak of.

Senator KERR. I would like to ask Mr. Stam: Was that considered by the House, the general levy?

Mr. STAM. No; the House did not go into the general levy.

Senator BYRD. What would be the revenue, Mr. Stam, from a general levy of 5-percent excise taxes?

Senator KERR. Manufacturers' excise tax, other than food, Mr. Chairman?

Senator BYRD. Other than food, what would be the exemption?

Mr. STAM. Of course, I say it would all depend on what exemptions you had.

Senator BYRD. Take it completely first, without any exemptions.

Senator MARTIN. Take it straight across the board.

Mr. STAM. Well, I do not think that you would get, for instance, on a 10 percent levy, much over 6 or 7 billion dollars out of it. I mean that is just a rough guess, the way things are running.

Senator BYRD. The plan as I understand it, is to limit it to 5 percent; in other words, it would be a reduction in certain excise taxes, is that correct?

Mr. BARIT. Yes; I visualize that.

Senator BYRD. What would be the effect to the Treasury, Mr. Stam, if we had a 5 percent over-the-board, across-the-board excise tax, and reduced those excise taxes that are above 5 percent? That is what you are discussing, is it not?

Mr. BARIT. Yes, seeking a reduction in the present levies.

Senator BYRD. To make them all 5 percent.

Mr. BARIT. I did not hit upon the exact figure, Senator, I was hopeful that it might result in even a greater reduction than that, but if it is 5 percent, it would help that much.

Senaor BYRD. Could you give the committee some rough idea, if that plan should be adopted, what would be the effect of the plan, Mr. Stam?

Mr. STAM. I do not believe I could give it to you right now, but it certainly would be some reduction in that figure I gave you. Of course, I might say on this point that Canada, for example, levies a general sales tax and, in addition to that, they have selective excise taxes at much higher rates on certain articles, but those articles that are subject to the excise-tax rate in Canada, also bear the sales tax so that when you are figuring the total tax burden on those particular articles, you have to add to your selective excise tax your general sales-tax rate, so that some of those articles are taxed pretty heavily.

Mr. BARIT. May I point out, Mr. Stam, that the Canadian situation is hardly analagous to our own, as we are a producing nation to a much greater extent than they are, and we have something of extrordinary importance to protect.

We have to protect the jobs of people, and unless we can handle our taxation so that the people can afford to buy the articles we produce, it is going to mean a reduction in production; that is, we have to protect trade to a much greater extent than Canada does.

Trade, as you know, is a very sensitive element of prosperity. It is easily discouraged. You can discourage it by overburdening selling prices, and I think, if I may be permitted to say so, that is the one "must" before us today. We must protect the economy of this Nation because we have a tremendous program. It requires enormous sums of money.

I know of no way, no safe way, of getting that money except through the creation of new wealth, and if we do not protect that, and go ahead willy-nilly, and do not recognize the importance of productivity. I see no hope for us, gentlemen.

I think there is another point to remember in that connection, and that is, that even though people are willing to buy—let us assume that we do have lower taxes, and that people are willing to buy—you still cannot have production, you cannot have that creation of wealth, unless the producers who are required to establish the productive facilities see a reasonable business risk in so doing.

Now, I think that is the nub of our problem, I think there is a wealth of meaning in that, and something that we should study, so that I think our situation is far different from that of Canada.

I do not know of any country that is quite analagous to the situation in this country.

Senator BYRD. Let me ask you about this excise tax now. As I understand it, what you mean by a general excise tax is a manufacturers' sales tax equivalent to that. In other words, it is a tax on a product to be sold at the manufacturing level. It is not a sales tax, a retail sales tax, in that sense.

Mr. BARIT. No; it is a general manufacturers' tax levy, eliminating food and shelter for the purpose of protecting the very low income people.

Senator BYRD. You would eliminate all building materials from it?

Mr. BARIT. Not necessarily. I was thinking of rents more than I was——

Senator BYRD. That is shelter.

Mr. BARIT. Building materials.

Senator KERR. The manufacturers' excise tax would not cover rents. I think if you exclude——

Mr. BARIT. I mentioned——

Senator KERR. I think if you excluded food, you would accomplish what you had in mind.

Mr. BARIT. Yes. I mentioned shelter, Senator, more to point out that the two things that represent the great bulk of the purchases of the very low income people, whom we should always keep in mind, are food and shelter.

Senator KERR. Food and rent.

Mr. BARIT. Yes, food and rent. And if they are taken care of——

Senator BYRD. You mean by that there would not be an excise tax on those products that went into building?

Senator KERR. No.

Mr. BARIT. That is not what I mean.

Senator MARTIN. You could make an exception there, Mr. Chairman, where it is individually owned homes; but if you get into apartment houses and things of that kind, you get into a lot of trouble; but if it would be individually owned homes which we should encourage in America—we are getting a little away from that.

Mr. BARIT. Senator, I did not get as far as that. I am aware of the point that Mr. Stam made that you should not exempt too much or it will defeat its purpose.

I feel that anyone who can purchase a home is somewhere beyond the class of very low-income people, whom I think we must always protect.

Senator MARTIN. But we have had in America very low-income bracket people who have owned their own homes, and that has been one of the things that make up the greatness of the American economy and the strength of American citizenship.

For example, in the city of Philadelphia, 50 years ago, we prided ourselves in the fact that 90 percent of the people owned their own homes, or had title to them. There might have been some indebtedness against them but they prided themselves on owning their properties, and that was the strength of that great city.

Mr. BARIT. I certainly subscribe to that, Senator.

May I again point out that that distinguishing statement of yours indicates how serious the situation is. You can scarcely turn in any direction—I will say you cannot turn in any direction—without feeling the weight of this terrible situation that we face.

That must be taxed, important as it is. The only exemption you can make is the very low-income fellow who could not think of buying a house. He is just able to buy food and shelter, and you should not make that too difficult for him.

Senator MARTIN. Of course, you could go to making exemptions in this kind of thing, and we will get into very serious trouble, because there will be, just like here this morning, no fellow who wants his own things taxed. We are all human——

Mr. BARIT. It depends on whose ox is being gored.

Well, suppose I eliminate shelter, which is somewhat difficult to understand, and controversial, and simply say food, because as the Chairman pointed out——

Senator MARTIN. Yes.

Mr. BARIT. Rents are not taxed under a manufacturers' excise tax, so we get down to food as the only exemption.

Senator BYRD. Your idea is that everything that is manufactured excepting food would be taxed?

Mr. BARIT. Yes, sir.

Senator BYRD. And that it would only be taxed after it was a finished product?

Mr. BARIT. Yes.

Senator BYRD. Suppose a man would cut timber and, say, sell that timber? Would that be taxed or not?

Mr. BARIT. No, just manufactured end products.

Senator BYRD. It would have to be a manufactured product?

Mr. BARIT. Finished product.

Senator BYRD. I see.

Senator MARTIN. As I understand, the sheets of steel and so on that you put in the automobile, they are not to be taxed until they are to be—until they are put into the finished product.

Mr. BARIT. And then it will be taxed because it goes to make up and swell the selling price, which carries the excise tax. You have a double taxation if you do the opposite.

Senator MARTIN. Yes.

Senator BYRD. Raw materials, so to speak, would not be taxed?

Mr. BARIT. Not until it becomes a finished product.

Senator BYRD. Not until it becomes a finished product, such as a finished automobile. Of course, there would be some difficulty, because some parts are not completely finished. They would be partially finished?

Mr. BARIT. But at some point or other, Senator, if we are interested in them, they find their way into a finished product, and then they are taxed, because they go to make up the total selling price which determines the amount of tax.

Senator BYRD. Senator Kerr, do you have a question?

Senator KERR. No, Mr. Chairman.

Mr. STAM. That is what we have now, Mr. Chairman. We have these sales for further manufacture under the present system that we have, where we have these manufacturers' excise taxes, where an article is going to be manufactured into a finished product—it is not taxed today.

Senator MARTIN. Yes.

Mr. STAM. And I suppose that would carry out the same principle.

Mr. BARIT. You could not have double taxation. I do not think you would want it.

Senator BYRD. Mr. Stam, if such a tax should be substituted for excise taxes in this bill, what difference would it make in the revenue up or down by leveling them off 5 percent—that is what you mean, is to level all excise taxes to 5 percent. Do you mean that on liquor, too?

Mr. BARIT. Liquor and tobacco have always been put in a separate category.

Senator BYRD. You would have to exempt those, too?

Mr. BARIT. I suppose you would retain the present levies on those articles.

Senator WILLIAMS. I think the Secretary of the Treasury testified that for each 1 percent, it would account for a billion dollars, minus food and from that amount you would have to subtract those taxes which we are now getting.

Senator BYRD. All right, Mr. Barit, thank you very much, sir.

Mr. BARIT. Thank you for listening to me so patiently.

(The prepared statement of A. E. Barit previously referred to follows:)

STATEMENT OF A. E. BARIT, PRESIDENT, HUDSON MOTOR CAR CO., AND CHAIRMAN, TAXATION COMMITTEE, AUTOMOBILE MANUFACTURERS ASSOCIATION

INDUSTRY DISTURBED BY WIDENED INEQUITIES

The automobile industry is profoundly disturbed by some of the glaring inequities of the pending revenue bill as adopted by the House. It is particularly disturbed because that bill widens instead of equalizing existing excise taxation discriminations among goods which compete for the consumers' favor.

Our industry—and I'm sure you know we have 912,000 employees and 45,000 dealers—is perfectly willing to pay its fair share of any taxes that may be necessary, after nondefense and nonessential Government expenditures are cut to minimum levels, to meet the higher governmental costs resulting from the defense effort.

Our "fair share," it seems to us in the automobile industry, should be defined as the result of the application of a uniform excise-tax rate to all manufactured end products except food and shelter. We think further that such taxes should be levied only for the period of the emergency and that they should carry an automatic termination clause.

As producers of automobiles and as American citizens we would fail in our duty if we did not call your attention to the tremendous burden of taxation already imposed upon automotive products. At the present time, with the excise-tax rate on passenger cars 7 percent, the total tax burden amounts to 20 percent of the total price of the automobile. Taxes of all kinds, Federal, State, and local, amount to $384 of the $2,000 total price of a typical new lower-priced car.

DISCRIMINATORY TAXES LIMIT FREE CHOICE

In view of the tremendous burden of over-all taxation now being carried by our people, the matter of public preference as to method of taxation becomes more than usually important.

Consequently we desire to register our belief that the majority of people would prefer the general excise tax (except on foods and shelter) to the present method of applying excise taxes only to a selected list of articles.

The reason for our belief is that the general excise-tax plan would tend to minimize the tax on each individual article and to thus avoid a prohibitively high tax on any particular item.

Few things could irritate a taxpayer more than to learn that the very thing he wants to purchase carries a disproportionate excise levy—perhaps beyond his ability to pay. We are sure he would much rather we spread the total excise take over all articles so that it would not put any particular article beyond his reach. He could then choose between the various articles he might like to buy.

As you probably know, there are 40,000,000 people in this country who are interested in what happens to the price of automobiles—there are that many cars now registered.

AUTOMOBILES AN ESSENTIAL IN WAR AS IN PEACE

This tax burden becomes doubly important when you consider the essentiality of motor vehicles. Surveys repeatedly have shown that more than half of all passenger car mileage is necessary, with 77 percent of all trips connected with earning a living or other economic activity, and with 95 percent of the Nation's 40,000,000 passenger cars used wholly or partly for essential purposes. This is one small facet of the story of the essentiality of the passenger car, contained in the document Automobiles and National Defense which we offer as part of our brief.

Few persons realize that motortrucks carry three times as much freight as the combined total hauled by all other forms of transportation. This is one of the interesting facts contained in the document Motor Trucks and National Defense which we also offer as part of our brief.[1]

Thus these taxes on automotive products represents a levy on instrumentalities clearly essential to the economic life of the people, clearly essential to the economy in war as well as in peace.

Further, in the case of the tax on replacement parts, which the House bill would raise to 8 percent from 5 percent, the excise is a tax on misfortune. Today's average car is nearly 8 years old, against a prewar average of 5.5 years.

[1] On file with the committee.

When you remember that most old cars are owned by people in lower-income groups, the inequity of this tax becomes apparent.

CONGRESSIONAL COMMITTEES AGREE AUTO TAXES UNFAIR

Our statement of willingness to pay our fair share of Federal taxes does not in any way change our position on the already existing high rates of excise taxes on automotive products. These taxes, when first imposed and again when they were increased, were labeled in official congressional reports to be unfair, discriminatory, and regressive. Your committee, as well as the counterpart committee of the House, accepted them reluctantly as "temporary" or emergency measures to meet then-current needs for revenue.

In our appearance earlier this year before the House Ways and Means Committee, no mention was made of the effect on the Nation's 8,000,000 truck owners of the proposed increases in automotive excises, for the reason that no proposal existed at that time for increasing the Federal tax on trucks.

In view of the intent of the House to increase truck excise taxes by 60 percent, or to 8 percent from 5 percent, we believe your committee should consider the following facts:

1. Recognizing that motortrucks are essential in the defense production, the Defense Production Administration has authorized almost maximum truck production.

2. As pointed out in the booklet Motor Trucks and National Defense, appended,[1] the Nation's trucking services are essentially unlike the services of other freight haulers, and these services are necessary not only to defense production but also to the efficient operation of all other freight carriers.

3. Most trucks are owned by individuals, or by small-business firms, so that discriminatory taxes on trucks are a direct burden on small operators. Farmers, for example, are the Nation's largest class of truck owners; they have more than doubled their use of trucks in the last decade in their production and marketing operations. Approximately 3,000,000 trucks are used by farmers.

4. No other vehicle for freight transportation, and no other tool of production or marketing, bears any Federal excise tax. Since the truck must be classed with farm tractors, industrial machine tools and similar tools necessary to farm and factory production for military and vital civilian purposes, a special tax on trucks appears justified only under a general manufacturers' excise levy for emergency revenue.

OPPOSITION TO DISCRIMINATION HAS BEEN CONSISTENT

In previous appearances before, and statements filed with, the Senate and House committees engaged in writing tax legislation, we have repeatedly opposed the existing structure of automotive excise taxes, for the reasons that—

1. They impede commerce by increasing the cost of moving goods and people;
2. They are an increasing threat to production and employment in the motor vehicle industry and in supplying industries;
3. They are taxes that affect lower-income groups relatively more than other income groups;
4. They are discriminatory, since they are not imposed on competitive forms of transportation, on other goods which compete with motor vehicle sales, or on other productive equipment;
5. They are unfair, as they place a relatively greater tax load on farmers, small town people and others who necessarily depend mainly or solely on automotive transportation; and
6. They are an extreme example of multiple taxation.

These obviously are sound reasons for opposing the existing automotive excises. The automotive industry in this emergency period nevertheless is not opposing excise taxes as such—provided the new schedule of excise taxes eliminates the present inequities and discriminations and provided that the emergency rates will be terminated automatically with the end of the emergency.

By ending these taxes with the end of the emergency, purchasing power would be increased, demand for consumer goods would be increased, production and employment would be increased and a solid base would be provided for a strong postemergency economy.

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[1] On file with the committee.

HOW AUTOMOBILES GENERATE ECONOMIC ACTIVITY AND TAXES

The automobile industry is particularly conscious of its actual and potential impact on commerce and industry generally, as one of every seven persons normally employed in the United States earns his living from the production, distribution, service, or use of the passenger car, truck, and bus.

The economic activity thus generated in turn stimulates the whole economy and has an incalculably important effect upon the profitable employment of the funds and services of all citizens with money or skills to employ.

It seems clear that excessive taxation on passenger cars and trucks, busses, replacement parts, tires and tubes, gasoline and oil not only weakens the mobility of the people, which is one of the basic advantages we have over most other of the world's people, but it also tends to defeat its purpose. This is because it tends to limit the use of an instrumentality which in itself generates activities which create income and thus provide wider sources for tax revenue.

Despite our willingness to support a general manufacturers' excise tax for the emergency period, the automobile industry wants the record to be clear that it continues to oppose the discriminations and inequities of the present excise taxes. The arguments we have advanced for repeal of the existing "emergency" and "temporary" taxes on cars and trucks, on repair parts and accessories, on tires and tubes, and on gasoline and oil have never been successfully challenged. We believe they are beyond challenge.

Senator BYRD. Mr. McPherson.

STATEMENT OF L. D. McPHERSON, WASHINGTON, D. C.

Mr. McPHERSON. Mr. Chairman and members of the committee, I would like to expedite this. This will take 8 minutes.

This is a supplemental statement before the Senate Finance Committee on the trailer-coach tax that was testified about here this morning.

I offer a prepared statement printed in seven pages as exhibit K of this supplement. The document clerk has that prepared statement.

I offer exhibits L, and M, and N, which the document clerk has.

I offer copies of the report of the coordinating committee for a national plumbing code, 1951, Domestic Commerce Series No. 28, issued jointly by the United States Department of Commerce and the Housing and Home Finance Agency.

Exhibit L of this booklet includes pages 111 to 118, inclusive; and is Appendix TC, Trailer Coach Plumbing Standards; and exhibit M consists of pages 119 to 121, inclusive, which is Appendix TP, Trailer Park Plumbing Standards.

The remainder of the booklet, exhibit N contains other parts of the National Plumbing Code.

House trailers have this apparent official recognition as sanitary dwelling units through recent competent sanitary research therein.

The families owning and/or occupying such house trailers throughout the year as their permanent dwellings are the real and principal parties interested in repeal of this 7-percent tax, having been in the position of absorbing its payment in its being passed on to them from the manufacturer.

Some 290,000 house trailers are reported as occupied by families as their dwellings throughout the year by the 1950 United States census as of April 1950.

Of those, 267,000 are owners or purchasers, and the others are tenants.

The history of the enactment of this tax appears on pages 2 and 3 of exhibit K which is before you.

Did the Congress mean to single out these house trailers as the only dwelling units of the many classes and cause to be subjected to the payment of such excise tax?

From this history, the relative ability to pay and the typical court decisions in such cases, as recited on pages 5 and 6 of exhibit K, this tax seems vulnerable.

In the interests of the Members of the Congress who might have participated in its enactment in 1941, or those who might now become responsible for continuing this tax, I hope they will consider freeing themselves of any intention so to tax.

I thank you, gentlemen.

(The prepared statement referred to (exhibit K) and exhibits are as follows:)

EXHIBIT K

STATEMENT OF L. D. MCPHERSON

I appreciate the privilege to appear to present the results of my considerable research since 1947 in health and sanitation laws and ordinances and scientific literature relating thereto, especially as affecting trailer dwellers.

This will be the briefest summary I can make of the material facts relating to the history of the 7 percent of the wholesale price of mobile housing collected as a Federal excise tax since October 1, 1941, pursuant to section 544, subsection (b), of the Internal Revenue Code (H. R. 5417), approved September 20, 1941.

I cannot find that this matter has ever before been presented for review in any hearings or debates of a revenue act.

I was engaged in the fall of 1948 by members of the American Society of Sanitary Engineering, serving them on its newly formed committee to survey the standards of sanitation thought to be necessary by the society for recommendation in regulating living in house trailers and trailer parks or courts.

Such standards are about ready to be prescribed, national in scope, for the first time, in two sections, one for trailer coaches, the other for trailer parks, by the coordinating committee for a National Plumbing Code sponsored by the United States Department of Commerce and the Housing and Home Finance Agency, as completed and approved in collaboration with and by some 38 specialists and technicians, representative of all interested groups—as an advisory committee, or delegates to the coordinating committee—jointly cooperating for the past 2 years.

An edition of 10,000 such codes is expected to start in circulation within about 60 days. Some 200 cities and other organizations have already signified their intention to adopt such code.

The scope of my survey or research, first herein mentioned, is indicated on the inner side of the flyleaf of a booklet containing 110 pages, published and copyrighted by me in 1949, entitled: "Regulation of: I. House Trailers and Their Locations; II. Plumbing in House Trailers, Trailer Parks, or Buildings Anywhere for Any Use." A copy of that booklet is here offered in evident as exhibit A of this paper.

Similar booklets of other legal and scientific sanitary research made by me soon thereafter are: Prevention of Water-Borne Diseases; Part I, Sewage, Its Treatment and Disposal; II, Water, Pollution and Purification—in 48 pages, here offered as exhibit B; and Some Provisions of the Statutes of the States Relating to Public Health and Sanitation, Including Plumbing. The reading of the latter, compiled in tabular form, requires a study of the inner side of the flyleaf thereof, in 67 pages, which is hereoffered as exhibit C.

Pursuing further such sanitary research, I bought a rare complete set of all volumes of Proceedings (yearbooks) of the American Society of Sanitary Engineering, and its predecessor, the American Society of Inspectors of Plumbing and Sanitary Engineers, for its 45 annual conventions, 1906 to 1950, inclusive, and compiled therefrom a comprehensive index of the sanitary literature produced and preserved by the society for 45 years through appearance of its members and other specialists serving on research committees as health laboratory technicians, in sanitary institutions, and public-health offices.

The American Society of Sanitary Engineering, of which I am a member, asked me for the privilege of publishing this comprehensive index of all their literature as an appendix to its 1950 convention yearbook or proceedings, which will appear in their edition of some 3,000 volumes. This index makes available for the first time the wealth of this rare literature.

I wish to make available to this committee all data I have gathered relating to mobile housing.

The effort I make before you is to help you bring into harmony the administration of subsection (b), section 544 of Public Law 250 (H. R. 5417), chapter 412, Seventy-seventh Congress, first session, relating to the 7-percent excise tax being collected on sale of mobile housing, house trailers, or trailer coaches with the Federal policy on public housing as manifested in the Resettlement Administration of 1935 and 1936 and other contemporaneous Federal public housing agencies, the Public Housing Authority, created and implemented by the National Housing Act of 1937, Seventy-fifth Congress, first session (ch. 896, United States Statutes at Large, pt. 1 (1937) pp. 888–889) and the Housing Act of 1949 (Pub. Law 171, ch. 338, 81st Cong., 1st sess., approved July 15, 1949) as to grants, contributions, and loans for public housing.

I offer as exhibit D a release by the Bureau of Census from its 1950 decennial enumeration of population and housing, dated February 15, 1951. I was instrumental in getting Census to include homes maintained in automotive trailers. This census shows 290,000 such homes, meaning year-round occupancy thereof. This figure does not include other trailer coaches used for business, offices, seasonal or recreational, vacation, occupancy, nor trailers made in United States. and sold in export trade, without payment of said 7-percent excise tax, pursuant to reciprocal treaties with the countries into which export is made.

I offer as exhibit E Public Law 250, chapter 412 (H. R. 5417), Seventy-seventh Congress, first session, Revenue Act of 1941, approved September 20, 1941, and specifically refer to said subsection (d), section 544, amending subsection (b), section 3403, of the Internal Revenue Code to read (p. 28): "(b) Other automobile chassis and bodies for trailers or semitrailers suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories thereof sold on or in connection therewith or with the sale thereof), except tractors, 7 percent. A sale of an automobile, trailer, or semitrailer shall, for the purpose of this subsection, be considered to be a sale of the chassis and of the body."

I suggest an amendment to this subsection (b), section 544, Public Law 250, approved September 20, 1941, in substance, inserted after the words, "passenger automobiles," equivalent words "except trailer coaches, house trailers or mobile housing, which is hereby relieved from payment of such or any other rate of excise tax as referred to in said subsection (b), section 544."

The Commissioner of Internal Revenue may not resolve the doubt of legislative intent to tax against the sovereign and thereby lose public revenue when the courts exist to relieve taxpayers from illegal taxation.

I have read the 324 pages of debates in Congress prior to enactment of H. R. 5417 (Pub. Law. 250, ch. 412, 77th Cong., 1st sess., approved September 20, 1941, Revenue Act of 1941), examined the 1,592 pages printed of the hearings before the Senate Committee on Finance and the 1,846 pages of hearings before the House Ways and Means Committee.

In none of these was found any mention of mobile housing, house trailers, or trailer coaches.

A national revenue measure is necessarily an omnibus bill and largely generalizes, rather than classifies, objects or persons for taxation, unless strong remonstrances were made by affected groups through hearings or otherwise.

During the debates on this act a rule was applied depriving Members of the right of offering amendments on the floor.

Among the items of comment in the debates pertinent to the excise tax, here complained of, was the following from Congressman West, of Texas:

"Personally it appears to me that orderly procedure in the House should require a point of order to lie against any item in a tax bill when it is brought to the attention of the House membership that such item is reported without hearings having been held thereon"; and by Senator Clark, of Missouri: "I defy anyone * * * to take this bill and run right through it and tell what everything in it means, * * * because it it a patchwork system."

The house-trailer industry and the house-trailer dwellers at the time this tax was imposed on them were so relatively few and so unorganized that no representation for either appeared during the consideration of passage of this Revenue Act for 1941.

Under the application of said subsection (b) in collecting the 7 percent excise tax on trailer-coach housing for nearly 10 years many of the some three-fourths million trailer dwellers are becoming familiar with having paid this excise tax on their small homes and are becoming resentful of the discrimination they suffer under it.

I refer to National Housing Act of 1937, Seventy-fifth Congress, first session (ch. 896, U. S. Statutes at Large, pt. I, pp. 888-899) for elimination of slums and in aid of families of low income and creating a United States Housing Authority.

This act provided loans of 90 percent of cost of dwelling units, authorized the Authority to contract to contribute toward operation of the public housing projects for as long as 60 years "from any money in the United States Treasury not otherwise appropriated"; authorized capital grants of 25 percent of the slum clearance or low-rental housing development or acquisition costs; authorized capital grants of $20,000,000, $10,000,000 of which was payable in each of the fiscal years 1938 and 1939; specifically appropriated other funds, $5,000,000 * * * and for the fiscal years 1938 and 1939, $7,500,000 each or a total of $20,000,000; and appropriated as of June 30, 1938, $26,000,000 or a grand total of $66,000,000; limited the costs of dwelling units to $4,000 or $1,000 to $1,250 per room for families, authorized a capital stock for the Authority of $1,000,000 to be subscribed for by the United States and authorized issuance by the Authority for the fiscal years 1938 and 1939 obligations in the amount of $100,000,000 and $200,000,000 respectively.

I offer as exhibit F Public Law 171, chapter 338, Eighty-first Congress, first session, Housing Act of 1949 (H. R. 4009; S. 1070), approved July 15, 1949.

Pursuant to the provisions of this act, Federal aids, capital grants, loans, and annual contributions, the latter extending long into the future, are made to assist local housing authorities in slum clearance and maintaining low-rent public housing.

Under this act local housing authorities have been organized to avail themselves of the privileges of the act to the number of some 600.

Such local authorities, 216 in number, contracted with the Bureau of Census in its decennial enumeration of 1950 for early report of houses defined by the Public Housing Administrator as substandard or dilapidated dwelling units.

I summarized these two latter classes as they appeared in the first 46 reports for as many local housing authorities and found about 574,000 reported as substandard. Of these about an average of 30 percent were reported as dilapidated.

I here offer as exhibit G 200 of these 216 apparent applicants for benefits under this act, being mainly local housing authorities organized since its passage. An estimate has been made that approximately 1,565,000 such substandard dwelling units, including the dilapidated units, are contained in this 216 local housing authorities reports from Bureau of Census. Surveys being made by others for local housing authorities are estimated to raise the number to about 400.

Other communities considering and yet eligible for applying for benefits to local groups under this act may raise the total to share under the act to 600 communities or groups.

A provision of this act restricts the number of dwelling units to be aided by it at "not to exceed 810,000" the beginning of construction being authorized by the act for that many, financed by aids by fiscal years in amounts as follows: $135,000,000 per year for each of the years 1949 to 1954, inclusive, "not over $200,000,000 to be expended in any one fiscal year." Obviously the 600 potential applicants to share under this act contain more than 810,000 dilapidated dwelling units.

Under section 513 of the act, capital grants are authorized to pay interest on borrowing by fiscal years:

1949	$2,000,000
1950	5,000,000
1951	8,000,000
1952	10,000,000
Total	25,000,000

Under section 305 of the act authority is given to contract to make annual contributions by fiscal years:

1949	$85,000,000
1950	55,000,000
1951	55,000,000
1952	55,000,000
1953	58,000,000
Total	308,000,000

plus $55,000,000 contingent allocation any time 10 percent of the total to be allotted to farm area.

Under section 512 contributions are authorized by fiscal years:

1949	$500,000
1950	1,500,000
1951	2,000,000
1952	2,500,000
Total	6,500,000

Under section 511 of this act "For housing and buildings of 'potentially adequate farms'" loans for fiscal years:

1949	$50,000,000
1950	75,000,000
1951	75,000,000
1952	100,000,000
Total	300,000,000

Evidence introduced at the hearings before the House Committee on Banking and Currency on H. R. 1272, Eighty-second Congress, first session, on defense housing and community facilities was that 38 percent of the 1950 peak year of production of dwelling units, amounting to more than 1,100,000 such units were financed by direct Federal funds appropriated or federally insured housing loans. Among these was between 135,000 and 200,000 units provided for construction in any one fiscal year.

Under section 303, subsection 15 (5), page 13 (exhibit F) is a recital of cost limits for construction of low-rent public housing, from $1,750 to $2,500 per room therein, unfurnished, or practically as high per room as the full cost of a modernly equipped and relatively luxuriously furnished trailercoach, having full complement of all modern sanitary plumbing fixtures.

I offer as exhibit H, series HC-1: 1950 United States Census of Housing, Preliminary Counts, and as exhibit I, series PC-2: 1950 Census of Population, Preliminary Counts.

The PC-2 and HC-1 series shows the change in numbers of dwelling units and of population State by State, county by county, and city by city is that, despite the tremendous increase in population, particularly the very rapid rise in birth rate from 1940-50, and the rationing of materials for dwelling-unit construction in the first half of the decennial period that dwelling units had been produced, mostly in the last half of the decennial period, approximately twice as fast as the birth rate throughout the whole 10 years.

Reverting to page 4 as to provisions of Housing Act of 1949 omitted, references to section 103 thereof authorizes capital grants for slum clearance and redevelopment by fiscal years: 1949 to 1953, inclusive, $100,000,000 per year, plus a contingent grant of $100,000,000; total, $600,000,000.

Under subsection (e), section 10, said act provides loans, by fiscal years: 1949, $25,000,000; 1950, $225,000,000; 1951, $250,000,000; 1952, $250,000,000; 1953, $250,000,000; total, $1,000,000,000.

This Housing Act of 1949 provides dwelling units costing, unfurnished, three or more times as much as the trailer dwellers enjoy while paying this 7 percent excise tax on his own mobile housing toward providing the more expensive housing for families of no lower income than his own, resulting in a double discrimination against the trailer dweller.

These trailer dwellers have not, and do not ask more of their Government than to be given the chance due them to be free of Federal excise tax in providing their own safe, sanitary, and economical homes within their ability to do so.

This mode of housing assures a home free of debt within about 7 to 9 years as against a 40-year period provided for in the Housing Act of 1949.

Redefining a house trailer as an automobile accessory for taxation violates sound legal principles of classification in that a house trailer partakes of no primary characteristic or function of an automobile, whose only service to it is to tow it from the place it is made to a more or less permanent place of use. If it was a load of hay so towed, it would still be hay and of no different characteristic or function.

A house trailer has much distinction in function and little in common with a freight or express trailer. The freight or express trailer has to remain constantly moving on the highway to gain earnings as to leave no comparison of the governmental services it enjoys with a house trailer, and is almost constantly connected to the automobile serving it. House trailers while being towed are most often out of the use for which they are designed.

Excerpt decisions of the State and Federal courts of last resort rendered from 1936 to 1946 follow:

"Under constitutional provisions that 'all taxes' shall be uniform on the same class of subjects of the words 'all taxes' include property tax, inheritance tax, succession tax, and all kinds of taxes, the subjects of which are susceptible of just and proper classification.

"Statutes including those providing for general and excise taxes, to be valid, must operate equally upon all persons of the same class" (6 A. 2d, 826. 59 N. E. 2d, 924).

"'Uniformity of taxation' means equality of tax burden and a tax to be uniform must operate alike on the classes of things or property subject to it" (33 A. 2d 320). "* * * Means all property of the same class must be taxed alike" (14 S. E. 2d 395).

"In classifying persons for taxation an obligation on the part of the taxing power to make available some benefit to them must exist" (31 A., 2d 289, 320 U. S. 741).

"Legislature * * * should not act * * * without consideration of ability to pay or benefits of government received" (135 P., 2d 523).

"* * * but classification must be based on differences furnishing a reasonable ground for distinction and not so wanting in substance as to permit one class to escape burden imposed on another class under substantially similar conditions" (15 N. W. 2d, 598).

"A tax measure, to be valid, must lay its burdens uniformly upon all those who come within a proper classification of persons to be subjected to its burden and such classification must have some reason for differentiation between those who are and who are not to be taxed and must be founded upon some natural, intrinsic, or constitutional distinction" (103 P. 2d 740).

"Taxpayers may be treated differently if they are of different classes * * * if it acts uniformly upon the whole of any single class of individuals or objects, and the classification is founded upon some natural, intrinsic, or constitutional distinction" (119 P. 2d, 197, 101 P. 2d, 244).

"A tax becomes offensive to the principles of equality when some individuals of a class, fairly arranged, are selected to carry a burden not similarly operative on all of the class" (195 So. 222).

"The use to which property is devoted, and its productivity constitute the measuring stick in determining its proper classification for taxation" (73 P. 2d 209).

"Test in determining whether classification within a tax statute may be upheld is, Does the classification rest upon a relative rational basis and is the tax uniform in respect to those similarly situated?" (308 U. S. 516.)

"To avoid unconstitutionality, a statute which applies only to those persons that fall within its specified path, must be reasonable and not arbitrary in classification, and must rest on some ground of difference having a fair and substantial relation to the object of the legislation" (36 A. 2d 666).

"The difference upon which a classification for tax purposes is made must be substantial" (128 S. W. 2d 581).

"The principle adopted by the legislature in classifying subjects for taxation must have reasonable justification" (165 S. W. 2d 632).

"Classification of persons for taxation must be based on reasonable difference or distinctions which distinguish members of a class from those of another class in respects germane to some general and public purpose or object of the particular legislation" (271 N. W. 2d 68).

"Classification as to subject matter is permissible, if there is a reasonable ground for making a distinction, that is, some substantial difference between the subjects classified and if the classification made bears a reasonable relation to the permitted end of government action" (12 N. W. 2d 625).

"The legislature cannot arbitrarily fix the measure of a tax by a fiction, and there must always be some reason based on fact for imposing a particular tax on a particular class" (309 U. S. 580).

"A discriminatory tax cannot be sustained against complaint if classification appears to be altogether illusory" (176 Md. 423).

"Taxation which applies to a portion of a class and omits a portion is not uniform and equal within the Federal Constitution" (13 A. 2d 703, 771).

"A nonuniform distribution of taxes is violative of the constitutional provision requiring uniformity on the same class of subjects" (7 N. W. 2d 753).

Sanitation for house trailer dwellers, within or without trailer parks has progressed under aggressive, scientific research from Anchorage, Alaska, to Miami, Fla., in Purdue University, Lafayette, Ind., in National Bureau of Standards, Washington, D. C., through tests in health laboratories operating under laboratory technicians of American Society of Sanitary Engineering until no type of housing can justify a claim of higher freedom from health hazards than a modernly equipped trailer coach.

Senator BYRD. Our next witness is Mr. Granville S. Borden.

STATEMENT OF GRANVILLE S. BORDEN, STANDARD OIL CO.

Mr. BORDEN. My name is Granville S. Borden. My office is in the building of the Standard Oil Co., of California, 225 Bush Street, San Francisco, Calif., where I serve this company as an employee in their tax organization.

I am elated at the privilege of being here, and I am very humble and profoundly grateful.

Although I appear here on behalf of my employer and on my own behalf as a patriotic American citizen, the matters which I shall present relate to basic national legislative tax policy and are more specifically of profound importance to every corporate taxpayer which has the privilege of electing to file its returns of income as a member of a group of affiliated corporations.

First, I shall state my petition and then in the time remaining I shall state reasons why I believe you should grant my request.

In the Excess Profits Tax Act of 1950, Congress granted relief or benefits to corporations which had unusual experiences in the base period such as accelerated growth, abnormalities, changes in products or services, increases in capacity for production or operation and depressed industries, during the base period.

Congress was particularly lenient also to those corporations which had deficits in the base period by providing that "in no case shall the net income be less than zero"—in other words, all deficits in the base period are eliminated.

On June 27, 1951, the Secretary prescribed the consolidated regulations pertaining to the Excess Profits Tax Act of 1950. Under the provisions of these regulations, qualified members of a consolidated group are effectively denied these benefits which Congress extended to every taxpayer. Under these regulations, if a member of a consolidated group elects to file its returns in consolidations, its deficits in the base period income even though under the Congressional mandate that "in no case shall the net income" of a "taxpayer" "be less than zero." Under these regulations if a corporate member is qualified for growth or qualified for relief under any of the other relief provisions it loses its benefits unless all other members of the group which commenced business prior to January 2, 1946, can collectively qualify for the same relief.

Thus the Secretary by regulations has imposed penalties or entrance fees in addition to the 2 percent penalty for the privilege of entering into consolidation, and these regulations may be said to have the force and effect of law.

Senators, I came here to implore you to state whether or not Congress intended to impose these penalties in addition to the penalty of a 2 percent increase in the surtax rate for the privilege of filing consolidated returns.

Senator KERR. Right there, Mr. Borden, it is very clear in the statute that Congress did not intend to do that, is it not?

Mr. BORDEN. That is our view, Senator. We feel very strongly about that, but the regulations are written so that——

Senator KERR. I am not talking about the regulations. You have read the statutes, have you not?

Mr. BORDEN. Yes, sir.

Senator KERR. Can you find in there any language whereby Congress said that in addition to the 2 percent added tax to be paid by those filing the consolidated return, that if any of the units have a credit or a base under the provisions of this act, that the inclusion of that unit in a group filing the consolidated return will take that base or that credit away from them?

Mr. BORDEN. No, there was not a word about that to that effect, and contrary, it is our construction, by reason of the fact that the words "the taxpayer" are used in every passage where they extend these benefits, the word "taxpayer" is defined in the code as every person subject to a tax, and the word "person" defined in the code as including every corporation.

Senator KERR. Whether it is a part of the group filing the consolidated return, or not?

Mr. BORDEN. Yes, Senator.

Senator KERR. Is not the hook they use to string you on here the one that says that to have a consolidated return accepted, you thereby waive objection to regulations that may have been imposed upon you by the Treasury?

Mr. BORDEN. Yes, sir; I am coming to that in my explanation.

Senator KERR. All right.

Mr. BORDEN. If it was not congressional intention to impose these additional penalties, then these corporate taxpayers should be informed by a simple clarifying sentence to supplement section 141 (c) of the Internal Revenue Code.

I have prepared such a proposed amendment, and I ask permission to insert it now in the record.

Senator BYRD. Yes, sir.

Mr. BORDEN. Now, I have stated my petition, and during the few minutes of my remaining time, I shall state the reasons why I believe my petition should be granted.

My reasons are based upon legal grounds, equitable grounds, and upon the grounds of sound legislative policy.

First from a legal standpoint—I believe that the Secretary has trespassed beyond the boundaries of the authority which you delegated to him; that he has prescribed regulations which contravene clear unambiguous provisions of the Excess Profits Tax Act.

I do not claim that his utter disregard of corporate entities is not compatible with good tax policy provided the cost of admission to consolidation were reduced below the 2 percent penalty, but I do claim that Congress did not intend to deny these benefits and relief as an additional penalty to the 2 percent increase in surtax which is specifically imposed.

Time will not permit me to argue the legal points supporting my claim that the Secretary's regulations contravene congressional intent, so now I ask permission to file a brief supplemental statement which will incorporate these arguments.

Mr. Chairman, may I submit that?

Senator BYRD. Yes.

Mr. BORDEN. Secondly, from an equitable standpoint—consider the current dilemma of these corporate taxpayers. Congress has provided that each corporation must consent to the regulations as a condition to filing in consolidation.

Congress has also provided that the taxes shall be determined, assessed, and collected in accordance with those regulations. Now, the regulations have been prescribed, and they appear to these corporations to be in derogation of the provisions of the statute.

Corporation returns are due and installments of the taxes must be paid now. Currently there may be no remedy at law to test their validity. Under these circumstances, it seems to me that these corporate taxpayers are entitled to know through a clarifying amendment in the Revenue Act of 1951, by language that cannot be misconstrued, whether Congress intended to impose these additional penalties as a condition to the privilege of filing consolidated returns.

Senator KERR. Let me interrupt.

As I understand your complaint, it is directed to the operation of the excess-profits tax.

Mr. BORDEN. To the computation of the tax under consolidation.

Senator KERR. You recognize that when a group of units file an income tax return, that with reference to their normal and their regular tax rates, the losses of one are offset by the gains of another, and that they cannot escape—they must, under the normal and the surtax, bring about the consolidation and offset losses with gains?

Mr. BORDEN. That is right.

Senator KERR. But your problem is in connection with bases and credits for the computation of excess-profits taxes, and you take the position that where Congress has given that to a corporate identity, that that should not be lost by reason of the fact that it is one of a group that files a consolidated return.

Mr. BORDEN. Exactly, Senator.

Senator KERR. All right.

Mr. BORDEN. Now, one more point from the standpoint of equity: Let us assume that Congress intended that this question of penalties should be resolved through the Secretary's regulations. Let us assume that the Secretary could select legally one of three roads: First, the antitaxpayer road, which would construe all points against the taxpayer; secondly, the protaxpayer road, which would permit the excess-profits credit of each member to be determined upon a separate return basis; by that I mean they could select invested capital or base period, whichever was the better, and so on; and third, a middle course under which no special penalties or special benefits would be extended to the taxpayer.

I claim that the Secretary has followed the antitaxpayer road; that he should have followed the middle course, and I claim that our proposed amendment leads down that road.

Finally, I urge you to clarify the law on the grounds of sound legislative policy.

Obviously, if you adopt a clarifying amendment, you will eliminate the necessity of much potential litigation. You will alleviate the congestion of tax cases in the United States Tax Court and in the Federal courts.

Moreover, you will be acquiescing in part to the strong public demand which is growing at accelerating rates for clarification and simplification of our tax laws and regulations.

From the enactment of the sixteenth amendment to date, there has been a most commendable attribute in the minds and in the hearts of our American people to self-assess themselves for the full amount of tax that they believe our Congress intended to impose upon them. The percentage of the revenue collected by self-assessment as compared with the amount collected by deficiency assessments, negligence or fraud penalties, is conclusive proof of the foregoing assertion. This commendable spirit inducing self-assessment must not be impaired. Our taxes cannot be collected simply by investigations and a threat of penalties or incarceration. We must, as a condition to the preservation of our national economy, preserve in the minds and in the hearts of our American people this patriotic spirit of honest dealing with its Government.

Now, as the burden of taxation increases, the demand from our citizens for knowledge of the basis upon which they are being taxed and the formulas for the computation of their taxes become more voluminous and more vociferous.

But, Senators, here is what is happening in America today. While the tax burden is being increased to maximum heights, the rules for its determination and computation become more complex and confusing. The ability to explain the "why" and the "how" become more and more difficult—and as a consequence, this commendable spirit is being impaired. If it takes too much concentration and study to unravel the complicated knots in our tax laws and regulations, many taxpayers may refuse to make the effort.

I am sure you will agree with me that there is no tax law more confusing than the Excess Profits Tax Act of 1950.

Senator BYRD. What about the proposed bill of 1951? Is that more or less confusing?

Mr. BORDEN. The 1951 bill?

Senator BYRD. The one we are considering now. Is it more or less confusing than the one of 1950?

Mr. BORDEN. Well, I have not gone into the House bill too thoroughly, Senator. I know this has got me bewildered. I spent half of my life on consolidations and I cannot understand it.

Senator BYRD. It is more confusing than the 1950 act.

Mr. BORDEN. It is confusing not only to the taxpayers, but to the multitude of competent Bureau examining agents throughout the United States. This confusion engenders inefficient administration all to the detriment of the Federal revenue.

Compared, however, to the Excess Profits Tax Act, the consolidated regulations are awful. I claim that no person of normal intelligence can understand them, and that this confusion has been engendered in a large measure by the desire of the authors of the regulation to impose these additional penalties on the privilege of filing consolidated returns.

In conclusion, therefore, I urge you to be ever mindful of this public demand for simplification and clarity and, as one step in answer to such public petitions, adopt the clarifying amendment which I have proposed. I urge you to tell these corporate taxpayers what Congress had in mind.

As a matter of fundamental justice, they are entitled to have their taxes imposed by the Congress and not by administrative decrees.

Thank you, gentlemen, for the privilege of making this appearance, and for your courtesy in permitting me to appear.

(The supplement to the statement of Granville S. Borden follows:)

SUPPLEMENT TO STATEMENT OF GRANVILLE S. BORDEN

This memorandum is submitted to supplement my statement before the Committee on Finance on July 31, 1951, in support of an amendment to the Internal Revenue Code clarifying section 141 in cases where members of an affiliated group filing consolidated returns are entitled to the benefits of the so-called relief provision of the excess profits tax.

Under the Excess Profits Tax of 1950, Congress provided special formulas for computing the excess-profits credit of average earnings companies in special circumstances. Growing companies, deficit companies, companies with increased capacity or new products, new companies and certain depressed industry groups were allowed to increase their credit to what Congress regarded as a fair measure of what normal profits should be.

Congress also provided that certain groups of corporations could file consolidated returns on payment of a 2 percent additional tax for the privilege. The law also authorized the Secretary of the Treasury to prescribe such consolidated return regulations "as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group may be returned * * * in such manner as clearly to reflect the income-and-excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability" (sec. 141 (b) I. R. C.) As a condition of filing consolidated returns each corporation joining in the group must consent to the regulations prescribed by the Secretary.

On June 27, 1951, the Secretary prescribed his regulations. These regulations, in my opinion, effectively deny the relief I believe Congress intended to give to the individual corporations joining in filing consolidated returns. They do this by requiring the whole consolidated group to qualify under the particular relief provision (Regs. 129).

One of our subsidiary companies started the manufacture and sale of a new product, detergents, during the base period. It qualifies for relief under section 435 (e) because of its increased sales of this new product. Its credit would be computed with the benefit of the formula contained therein. In a consolidated return one would think that its credit is its credit as computed under the applicable provision of the statute. But that is not the case. Under the Secretary's regulations, if it chooses to file a consolidated return no account is given of its growth. Only when all the corporations taken together qualify by having new products may the growth formula be applied (Regs. 129, sec. 24.31 (b) (15) (ii) and sec. 24.31 (b) (16)).

Let me cite another example. Another of our subsidiary companies, about January 1, 1946, entered the highly competitive field of retail marketing of petroleum products in a new territory. It naturally had losses during the development period in the base period. Now it is profitable. The company had so-called deficits during the base period. Under section 435 (d) of the code it is expressly provided that "in no case shall the excess profits net income of any month be less than zero." From that one would think that in computing its credit, zero is to be used rather than the minus figure of its loss. But no. The regulations (sec. 24.31 (a) (64)) provide: "The consolidated section 433 (b) excess profits net income for any month shall be an amount equal to the excess of the combined net income of the affiliated corporation for such month over the combined deficits in excess profits net income for such month determined under section 433 (c)." So, the result is that this company's losses are counted in full and its part of the excess-profits credit is reduced and the consolidated excess-profits credit is reduced. It is only where the whole consolidated group has a deficit that the deficit is counted at zero under the regulations.

May I remind you that under the World War II excess-profits tax deficit (loss) years were subtracted from gain years to determine the average. In the 1950 act that rule was expressly rejected, and both committee reports emphasize the change and point out that the provision is designed to reduce the need for specific relief. (See S. Rept. No. 2679, 81st Cong., 2d sess., pp. 6 and 18.)

I can point to similar illustrations involving all the various relief provisions relating to the computation of the credit in the excess-profits tax. I am certain that other corporations will find themselves faced with other aspects of this very problem.

It is my belief that had the specific question to which my remarks are addressed been put to you gentlemen in the formulation of the Excess Profits Tax Act of 1950 you would have amended it as I propose rather than the way the regulations provide.

Let me put the question again. If a corporation is entitled to the benefits of growth on its own, shall it be deprived of those benefits in computing its credit when it joins in with others in filing a consolidated return? No reason of policy or administrative convenience requires a positive answer. Congress was, and I trust still is, trying to find what is a fair credit to measure what profits are excessive and should be taxed up to a rate of 72 percent in the case of consolidated return corporation. If a corporation meets the tests which Congress has determined qualify it for relief, is it any the less not entitled to relief if it files a consolidated return? It is submitted that the credit of the consolidated group attributable to that corporation is the amount of its own credit. That segment of the base-period earnings represented by the earnings of the subsidiary is entitled to be raised to a fair standard of earnings when brought into the earnings base of the affiliated group to measure excess profits.

It is no answer to our problem to state that the benefits of the relief provisions are not allowed to the respective departments of a business operated as a single corporate entity—that when a consolidated return is filed the whole group elects to be treated the same as a single corporation. It must be pointed out that the single corporate entity does no pay a 2-percent additional penalty, either. The real question is, What does Congress believe to be the right rule? The law gives a subsidiary of a corporation the same relief as its competitor across the street similarly circumstanced. And since it does, should the fact that the subsidiary files a consolidated return with its parent destroy that relief? We submit that it should not. The actual earnings of the subsidiary are just as inadequate a measure of the earnings during the base period, whether they are used as a measure of the earnings of the single corporation or as a part of the measure of the whole group of which it is a member. The fact that it may be either impractical or undesirable to grant relief to the departments of a single corporate taxpayer does not require its denial where it is both practical and just to grant it to the separate corporate entities on payment of the 2-percent fee for filing consolidated returns.

The subject of consolidated returns is a complicated one. Congress has left to administrative determination the myriad details of how the computation should be made. The problem here is not a detail. It is a major question of policy which Congress must determine. Believing as I do that the interpretation placed upon the statute in the regulations does not properly reflect the intention of Congress, I believe that Congress should specifically legislate on the matter to correct that interpretation.

We urge clarification now for the reason that the high tax rates compel a very difficult choice. That choice is to consent to the regulations, pay the tax and then seek to upset the regulations by litigation in the courts. At best, this is an expensive lengthy process involving uncertainty, hardship, and delay. It is highly desirable to avoid the confusion and litigation which will ensue over whether the position taken herein is the intention of Congress or whether the Treasury position carries out that intention.

I have proposed a simple nontechnical amendment which I submit for your consideration. It is almost self-explanatory (a bit unusual for an excess profits tax amendment).

Amend section 141 (e) (relating to consolidated returns) by adding the following new sentence:

"For the purposes of the tax imposed by section 430 (the excess profits tax), if any member of the affiliated group is entitled to the benefits of section 435 (d) (deficits), 435 (e) (growth), 422 (abnormalities), 443 (change in products or services), 444 (increase in capacity), 445 (new corporation), or 446 (depressed industry subgroups), the amount included with respect to such member in the average base period net income of the affiliated group shall be the amount computed with respect to such member under whichever of such provisions is applicable to it." This amendment is effective with respect to taxable years ending after June 30, 1950.

The proposed amendment, I submit is right as a matter of policy. I also believe that such was the intention of Congress when the present excess profits tax was enacted. I earnestly urge its adoption.

Senator BYRD. In lieu of appearance there will be inserted in the record a statement by the Southwestern Public Service Co., W. F. Stanley, vice president and secretary of the firm.

(The document referred to follows:)

SOUTHWESTERN PUBLIC SERVICE CO.,
Dallas 1 Tex., July 26, 1951.

CHAIRMAN AND MEMBERS OF SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.

GENTLEMEN: This brief is submitted in behalf of Southwestern Public Service Co., an electric utility operating in Texas, New Mexico, and Oklahoma with its executive office at Dallas, Tex.

THE PROPOSED AMENDMENT

Your committee is respectfully urged to consider incorporating in the pending Federal tax legislation an amendment to section 26 of the Internal Revenue Code to provide for the deductibility for the purpose of corporation normal tax and surtax of dividends paid by regulated public utilities (as now defined in said section) on the preferred stocks of such companies to the extent of 100 percent of the amount of the dividends so paid, such provision to apply to all preferred stocks of such companies now outstanding, as well as to preferred stocks which may be hereafter issued by such companies for the purpose of financing expansion or to refund indebtedness or other preferred stock.

LEGISLATIVE HISTORY

The present provisions of section 26 permit deduction for normal and surtax purposes of 31 percent of the amount of dividends paid by public utilities (as defined) on preferred stocks issued prior to October 1, 1942, and on preferred stocks issued to refund indebtedness or other preferred stock issued prior to such date.

This deductibility of preferred stock dividends was originally incorporated in the code by the Revenue Act of 1942, at which time the permitted deduction was 100 percent of such preferred stock dividends, but for surtax purposes only. In the Revenue Act adopted in September 1950, the deduction was made applicable both to normal and surtax, but the amount deductible was decreased from 100 percent of such dividends to 31 percent thereof, the purpose of this change being apparently to make the deduction with respect to normal and surtax at the new rate equivalent in amount to the 100 percent deduction previously permitted for the purpose of the 14 percent surtax only. In the new revenue bill as passed by the House which provides for a combined normal and surtax rate of 52 percent, the deductible percentage of such dividends is reduced to 27 percent, this percentage of the new rate again being equivalent to a 100 percent deduction of the original 14 percent surtax.

NEED FOR FURTHER TAX RELIEF FOR THE ELECTRIC UTILITY INDUSTRY

The electric utility industry as well as the other regulated utilities have received fair and reasonable treatment with respect to liability for excess-profits tax. Also the provision contained in the current House tax bill for the repeal of the 3⅓ percent tax on sales of electric energy for residential and commercial purposes (in which repeal it is hoped your committee will concur) will also be beneficial to the electric utilities in offsetting at least a portion of the impact of the higher tax rates.

However, the electric utility industry still sorely needs further relief from the impact of any increase in tax rates above the present 47 percent level, if it is to continue to finance the expansion of its facilities which is essential to the defense effort.

Shortly before representatives of the Edison Electric Institute testified before the House Ways and Means Committee in November 1950, in the matter of excess profits tax, inquiry was made by the institute of all the electric utility companies which were members, as to the relative impact on their earnings of the excess profits tax measure as originally presented by the Treasury Department, as against an increase in the normal and surtax rates to an aggregate of 50 percent. The majority of the responses indicated that a 50-percent rate would reduce earnings further than the relatively drastic provisions of the excess profits tax proposal made by the Treasury Department.

The figures for 1950 now show that the electric utility industry was able, by virtue of new business from the defense effort and normal increase in the civilian economy, to offset in that year, the impact of the increase in tax rate from 38 to 42 percent.

However, in the first 3 months of 1951, during which the 47-percent rate was effective, earnings have fallen below the preceding year. For the month of April 1951 (the latest month for which figures are available) net income of electric utilities was 5.2 percent below the same month in 1950, and after giving effect to the issuance of additional shares of common stock to finance expansion, it is estimated that per share earnings of the common stock of electric utilities were 10 percent below the figure for April 1950.

Per share earnings are the only figures which will give a true earnings comparison, for while net income of the industry may rise as new facilities are installed, and new business transacted, the per share earnings are being constantly diluted by the issuance of additional shares of common stock upon sale to the public to finance expansion. And the ability to sell common-stock equity in the market depends upon its ability to increase, or at least maintain, its earnings per share of stock outstanding.

Repeal of the electrical energy tax will be helpful in offsetting a portion of this decrease in per share earnings. The effect of such repeal in dollars of income is somewhat difficult to determine, but at best it is not anticipated it would do more than offset about one half of the 10-percent decrease in per share earnings indicated by the results of April operations.

Therefore, if it were assumed earnings would continue on the basis of the April 1951 figures, an increase in the normal and surtax rates from an aggregate of 47 to 52 percent, as provided in the House bill, would probably result, (even after giving effect to the benefit of the repeal of the electrical energy tax) in a decrease of 12 percent in per share earnings of the common stock of the industry for the period after the new 52-percent tax rate became effective.

In 1950 the proportion of earnings paid out in dividends by the electric utility industry was about 74 percent. Giving effect to a 12-percent decrease in per share earings, the over-all average dividend pay-out would rise to about 84 percent.

However, a recent statistical tabulation made by a New York investment house shows that of 71 electric utilities included, 16 had a dividend payout of 80 percent or more, with an average of about 85 percent. A 12-percent decrease in per share earnings with respect to these companies would increase their average pay-out to about 97 percent.

In 1950 the electric utilities raised through the sale of additional common stock to the investing public, including their stockholders, over 50 percent of all new equity money raised by American corporations, and this, despite the fact that their share of the national corporate taxable income was probably around 3 percent. This includes sales of preferred stock as well as common stock. Figures do not appear to be available for sale of common stock by all corporations, but it is believed that the proportion of the electric utilities would be much greater than 50 percent—perhaps two-thirds or 75 percent. The necessity of continuing to sell large amounts of common stock to finance the equity portion of their expansion program therefore, puts electric utility industry in a unique position.

It is estimated that the industry must expend over $7 billion within the next 3 years to finance further expansion which is essential for the defense effort and the civilian economy. Of this amount probably $1 billion will have to be in the form of additional common stock.

Common stocks of electric utilities customarily sell primarily on an investment basis. Most of the purchasers of these securities are interested primarily in stable and continuous income rather than in speculative profits. For this reason, the maintenance of dividends on these stocks is extremely important. Electric utilities have generally followed a liberal policy in the payment of dividends, and because of the relative stability of the industry and the recognition of the fact that more generous dividends will best attract investment at a reasonable rate, they have in recent years increased the proportion of earnings distributed in dividends to a point believed to be higher than any other industry. Investors, security analysts and institutions now generally feel that a payout of from 75 to 80 percent, or even somewhat higher is adequately protected by the earnings power, so long as future prospects are reasonably good. But where the dividend payout rises, or threatens to rise to over 90 percent, as would be the case as to a considerable segment of the industry under the impact of the increased tax rate provided in the new House bill, the maintenance of present dividends by these companies would be endangered.

Any reductions in dividend rates, or even the fear of such reductions in the minds of the investing public and security analysts, as a result of prospective reduced earnings because of higher taxes, might well undermine the confidence of the investing public in the industry and reduce prive levels to a point where the common stock financing necessary for expansion could be accomplished only at a prohibitive cost, if at all.

Many of the companies with high dividend pay-outs are those in the most rapidly expanding areas where it is imperative that they continue to sell common stock to meet their unusually high expansion needs, because of the rapid growth of the territory, both as to defense work and civilian economy.

While rate increases may ultimately restore all or part of the reduced earnings, these rate proceedings may be protracted, and until the increases are actually granted, the investing public will have no assurance that earnings and dividends can be maintained.

It is submitted that these unusual factors make it advisable in the interest of the defense effort and the national economy that some further relief be extended to the electric utility industry in the pending tax legislation.

It should be emphasized that the liberal dividend policy followed by the electric utility industry has resulted in the collection of substantially greater taxes by the Treasury, and will continue to so result, so long as these dividends can be maintained.

It is believed that American corporations generally paid out in dividends in 1950 something less than 50 percent of their earnings, as against the 74 percent of earnings distributed by the electric utility industry.

The following table gives a comparison of the total taxes receivable by the Treasury from each dollar of taxable income of the electric utilities and of all American corporations, based on dividend distributions for 1950, and on the average rates to recipients of dividends reflecting the increased individual rates proposed in the House bill:

	All corporations	Electric utilities
Taxable income	$1,000	$1,000
Corporate tax (present rate)	$470	$470
	$530	$530
Dividends paid	[1] $264	[2] $392
Average tax on recipient at assumed rate of 44 percent	$117	$172
Total taxes paid by corporations and recipients of dividends	$587	$642
Percent thereof to taxable income	58.7	64.2

[1] 50 percent.
[2] 74 percent.

On the foregoing basis, the Treasury will collect additional taxes aggregating over 5 percent of corporate taxable income in the case of electric utility companies, as compared with other corporations, due to the liberal dividend policy followed by the electric utility industry.

PREFERRED STOCK DIVIDENDS OF UTILITIES ARE IN EFFECT FIXED CHARGES

It is respectfully submitted that preferred stock dividends, while not legally obligations of regulated utilities, have come to be regarded as the equivalent of fixed charges on the income of utilities. Preferred stock is now generally recognized as a normal component part of the capitalization of operating utility companies. In the so-called El Paso case, the Securities and Exchange Commission set a formula for normal capitalization of utilities of 50 percent debt, 25 percent preferred stock, and a minimum of 25 percent in common stock equity. The Commission has at times approved of a somewhat larger debt percentage, and has considered the 25 percent common stock equity ratio as a minimum, favoring a somewhat higher percentage wherever possible.

At December 31, 1950, the capitalization of the electric utilities of the United States consisted of approximately 50 percent in bonds and other long term debt, approximately 14 percent in preferred stock, and the balance of about 36 percent in common stock equity.

That preferred stocks are today a normal component of the capital structure of electric-utility industries is evidenced by the fact that of 87 electric utilities covered by a recent statistical tabulation made by one of the leading investment banking houses in New York (which tabulation includes practically all the leading electric utilities of the country) 77 of these companies had preferred stock outstanding (in substantial amounts), and only 10 had no preferred stock outstanding. Of the 10 companies having no preferred stock, the majority consisted of large companies located in the centers of population, and where the rate of expansion of their properties to meet increased demands have not, in the past 5 years, been as great as in smaller communities located in the rapidly growing sections of the country. These larger companies, because of their strong credit position and lower rate of expansion, do not have the same need of tax relief as the smaller and rapidly expanding utilities.

In 1948 and 1949, when the market for utility preferred stocks was depressed by general conditions, institutional and other purchasers of the preferred stocks required a sinking fund or purchase fund to retire the issue in annual installments. Due to the depressed price of Government bonds and to the high-grade corporate-debt securities since the spring of this year, the market for utility preferred stocks has been adversely affected to a substantial degree, with the result that in order to market such securities today it is understood that substantial annual sinking or purchase funds may be required, in many cases running as high possibly as 3 percent, 4 percent, or 5 percent per annum.

While these payments are not obligations in the sense of debt payments, they are a condition to the payment of any common-stock dividend, and therefore, for practical purposes, are as binding on the company as an unconditional legal obligation, since it would be impossible to finance expansion if common-stock dividends were interrupted. Such sinking-fund provisions would require the retirement of preferred stock more rapidly than sinking-fund provisions with respect to bonds or long-term unsecured debentures. An anomalous situation would thus be created whereby dividends on preferred stock, which would have to be fully retired in annual installments over a 20-to-30-year period, would not be deductible for normal or surtax purposes, whereas interest on bonds or other debt securities, having lower sinking-fund requirements, would be deductible for tax purposes.

TEMPTATION TO INCREASE DEBT

Quite apart from the need of electric utilities for some further relief from mounting Federal taxes is the steadily increasing inducement to the industry to finance expansion to a larger degree by issuing bonds or unsecured debt instead of preferred stock. This inducement arises from the increasing "spread" between the cost of money raised by the sale of unsecured debentures and the cost of preferred-stock money.

Fifteen months ago, before Korea, an average electric utility could have issued unsecured debentures at a cost of about 3 percent per annum. After deducting taxes of 38 percent, the net cost of the money would have been 1.86 percent. At the same time, it could have sold preferred stock at about a 4-percent dividend rate, but since it could not deduct the dividends for tax purposes the difference in cost at that time would have been about 2.14 percent.

In other words, the cost of the preferred stock money would have been a little more than twice that of unsecured-debt money. Since then, the cost of money has increased substantially (due primarily in the break of prices of United States Government bonds), and there has also been an increase in tax rates.

Accordingly, at the present time, the same company would probably have to pay 3.6 percent per annum for unsecured debenture money (or 20 percent more than before Korea), and after deducting taxes at a 52-percent rate (as in the House bill) the net cost would be only 1.73 percent. Thus, the net cost of the debenture money, after taxes, would be slightly lower than before Korea. On the other hand, the present cost of preferred-stock money would range from 4.8 to 5 percent. Assuming a rate of 4.9 percent for preferred stock, and without the benefit of any tax deduction for the dividends, the difference in cost would be 3.17 percent per annum. This difference is nearly 50 percent higher than it was 15 months ago, so that preferred-stock money would now cost almost three times as much as the net cost of unsecured-debt money, after taking into consideration the benefit of the tax deduction.

Obviously, this increasing excess in the cost of preferred-stock money over debt money is a strong temptation to electric utilities to finance through debt securities to the greatest possible extent.

While issuance of such securities requires approval of Federal or State commissions in most cases, and while trust indentures of many companies contain limitations on the proportion of debt to total capitalization, nevertheless, a considerable increase in the percentage of debt above present limits is entirely possible. Management of the electric utilities would be loath to adopt such a financial policy, but might feel there was no satisfactory alternative under the impact of higher taxes and before any rate increases could become effective.

Such a development would weaken the credit standing of the electric-utility industry and tend to weaken its capital structure, thus reversing the trend toward sounder and more conservative capital structures which has developed over the past 10 years.

If provision were made for the deduction of dividends on preferred stock issued for purpose of expansion, the tax saving at the 52-percent rate would reduce the net cost of preferred-stock money in the present market to 2.35 percent, or only about one-third more than the net cost of unsecured-debt money, as compared with the present differential of about 280 percent.

Such a provision would therefore greatly lessen the inducement to finance through a larger amount of debt securities and would thus be helpful in maintaining sound capital structures for the electric-utility industry, and thus facilitate the common-stock equity financing of the industry which is essential to expansion.

CONCLUSION

In 1950 the electric-utility industry paid $112,000,000 in perefered-stock dividends. It is estimated that about two-thirds of this amount related to preferred stock issued prior to October 1, 1942 (or issued to refund such latter stock), and which is therefore presently entitled to the deduction of dividends for tax purposes to the extent of 31 percent (or 27 percent of the dividends under the House bill).

Accordingly, under the present law, about $23,000,000 of such dividends would be so deductible, leaving about $89,000,000 not deductible.

If this latter amount of dividends were made deductible, this would be a saving to the electric-utility industry in taxes of about $45,000,000. On the other hand, such tax relief should assure the maintenance of dividends on the common stock of electric utilities at present rates and thus assure continuance of necessary equity financing for the heavy expansion program required for the next 3 years.

Furthermore, maintenance of such dividends would also maintain the collection of revenue by the Treasury from taxes on the recipients of such dividends, for, if it became necessary for any substantial part of the industry to reduce dividends because of lower earnings due to the impact of the increased tax rates, the Treasury Department might suffer considerably through reduction in taxes collected.

As pointed out above, the liberal dividend policy followed by the electric-utility industry, and the consequent collection of larger amounts of taxes from recipients of the dividends, has resulted, and is now resulting, in the collection by the Treasury of taxes on the taxable income of the electric-utility industry at an aggregate rate 5 percent greater than that collected on the taxable income of American corporations generally; i. e., 64 percent versus 59 percent. This 5-percent increase in rate, when applied to taxable income of the electric-utility industry, woud almost exactly offset the increase in tax rate from 47 percent to 52 percent proposed in the House bill. It considerably exceeds the relief which would be granted to the industry by the proposed full deductibility of preferred-stock dividends, taking into account the loss in revenues to the Treasury which might result from the reduction in common-stock dividends if adequate relief is not afforded.

It is respectfully submitted that to rely solely upon rate increases to restore the reduction in earnings of the electric-utility industry due to an increased tax rate is to embark on a very serious gamble with the expansion program of the industry. This program, so necessary to the defense effort and the continuance of civilian economy at maximum levels, is dependent upon successfully raising from the investing public a very substantial annual amount of equity funds by the sale of common stocks. Unlike most industrial corporations, the rate of expansion of electric utilities has been and will continue to be so great that they cannot provide the portion of the new financing necessary to maintain proper common-stock equity ratios in relation to total capitalization by retaining a portion of their earnings, but must go to the investing public for new money at frequent intervals.

Reduction in dividends by even a few companies, under the impact of the higher taxes, might undermine confidence in the maintenance of dividends on the common stocks of other companies to such an extent as to create a chaotic market in which the necessary equity financing could not be accomplished.

Also, leaving aside the uncertainties and delay incident to proceedings for rate increases, it seems inequitable that utility consumers should be required to restore by rate increases the amount of additional taxes resulting from the increased tax rate when the stockholders of the electric utilities are already paying a like amount into the Treasury as additional taxes on the dividends received by them because of the liberal dividend policy which the industry has been following, and as to which it is unique among American industries.

Under the circumstances outlined above, it is hoped that your committee will give serious consideration to the unique problems of the electric-utility industry and will find it equitable and feasible to provide for the relief requested in the pending tax legislation.

Southwestern Public Service Co. operates an interconnected electric system in the States of Texas, New Mexico, and Oklahoma in a territory comprising the Texas and Oklahoma Panhandles, the so-called South Plains region of Texas and the Pecos River Valley in New Mexico. The population of this territory is about 625,000, and the area served is larger than the States of Pennsylvania and Rhode Island combined. This territory has been experiencing a rate of growth believed to be as high as that of any other electric utility in the United States. The company's plant and property have increased from about $38,000,000 at the end of World War II to almost $120,000,000 today, almost entirely through the construction of new facilities to meet the increasing demands. To finance this expansion, the company has made five offerings of common stock to its stockholders—one in each of the 5 years from 1947 through 1951. It has consistently followed a policy of paying liberal dividends, and the proportion of its earnings paid in dividends for its fiscal year ending August 31, 1951, is estimated at about 86 percent. It is, therefore, itself sorely in need of relief from the impact of further increases in the Federal tax rates. The relief afforded by the amendment hereinabove proposed would contribute substantially toward assuring maintenance of the company's present dividend rates, and in creating confidence in the security market that the dividend can be maintained. The proposed relief is, therefore, most respectfully urged in behalf of the undersigned company, as well as that of the electric-utility industry as a whole.

W. F. STANLEY,
Vice President and Secretary, Southwestern Public Service Co., Dallas, Tex.

Senator BYRD. In lieu of appearance, there will be inserted into the record the statement of Arthur Kuiper, treasurer and comptroller of the Continental Foundry & Machine Co., of East Chicago, Ind.

(The statement referred to follows:)

STATEMENT OF ARTHUR KUIPER, TREASURER AND COMPTROLLER OF CONTINENTAL FOUNDRY & MACHINE CO.

My name is Arthur Kuiper, and I am treasurer and comptroller of Continental Foundry & Machine Co., a Delaware corporation which has its principal place of business in East Chicago, Ind. Continental is a relatively small manufacturer of metal working machinery, including rolling mills, steel-plant equipment and rolls, castings of various types, etc.

Continental is in a period of rapid growth in the volume of its business. Because of this fact, its excess-profits-tax credit computed under the normal earnings on invested capital method bears an abnormally low ratio to the volume of its business. We believe that Congress intended to afford relief for companies such as Continental under section 435 (e) of the Internal Revenue Code, included in the Excess Profits Tax Act of 1950, which provides an alternative based on growth for computing the average base period net income. Indeed, Congress has provided effective relief, unless certain United States Treasury tax-saving notes held by Continental on January 1, 1946, for the discharge of its abnormal World War II tax and renegotiation liabilities, are considered to be assets of the company within the meaning of section 435 (e).

One of the tests of eligibility for relief under that section provides that total assets of the taxpayer shall not exceed $20,000,000 on January 1, 1946, and total assets are defined as an amount equal to the sum of the cash and property other than cash held by the taxpayer for the purposes of the business. On January 1, 1946, the total assets of Continental, carried on the assets side of its balance sheet, were approximately $14,000,000. On that date, Continental held United States Treasury tax-saving notes in the amount of $12,000,000, $4,000,000 of which were carried on the assets side of the balance sheet. In accordance with accounting research bulletin No. 14, prepared by the committee of accounting practice of the American Institute of Accountants, the remaining $8,000,000 of tax notes were carried on the liabilities side of the balance sheet as a credit against Continental's liability for renegotiation refunds and for income- and excess-profits-tax payments. In purchasing such tax notes, Continental undertook to discharge insofar as possible its abnormally high liability for past wartime obligations to the Government. These tax notes were not held for usual business purposes.

Nor do the $8,000,000 of tax notes in any way reflect the size of the company. Early in 1946, Continental began to apply the notes in payment of taxes, and from mid-1946 through 1949, the end of the base period, Continental's total assets, even including tax notes, never reached $20,000,000. Thus it is clear that at no time prior to the end of 1949 was Continental actually a $20,000,000 corporation. The tax notes were acquired and held simply in an effort to discharge the wartime tax and renegotiation liability accrued during 1945, prior to the beginning of the base period. We believe that in enacting section 435 (e), the Congress clearly intended to provide relief for relatively small corporations such as Continental, whose assets held for normal-business purposes amounted to less than $20,000,000. The $20,000,000 limitation was imposed in order to maintain a competitive balance between such corporations and corporations with larger resources available for their operations. These tax notes were not funds available for Continental's usual business operations.

We have recently requested the Commissioner of Internal Revenue to rule that Continental is eligible to compute its average base period net income for the purposes of the Excess Profits Tax Act of 1950 in accordance with the provisions of section 435 (e), and we hope to receive a favorable ruling in the near future. However, time was too short to expect a ruling before the date set for my appearance here, and we felt it desirable to outline to you the problem, should it become necessary, as we sincerely hope it will not, to ask for legislative clarification of the coverage under section 435 (e).

Senator BYRD. Mr. Main?

STATEMENT OF FRANK WILBUR MAIN, SENIOR PARTNER, AND M. C. CONICK, EXECUTIVE PARTNER, MAIN & CO., CERTIFIED PUBLIC ACCOUNTANTS

Mr. MAIN. Mr. Chairman and members of the committee, this presentation is entitled, "Federal Taxation and Inflation—the Law of the Take."

I am Frank Wilbur Main, senior partner of Main & Co., certified public accountants.

Very briefly, I should like to give you certain views concerning Federal taxes and inflation.

These are based on close acquaintance with tax problems over a period of years in a professional capacity and particularly on much careful research and specialized study in the field of Federal taxes which my associates and I have conducted during the past 8 years.

My chief associate in this work has been Mr. M. C. Conick, executive partner of Main & Co., who is here with me.

The original purpose of our special studies was to simplify the tax structure. Later we saw the need to provide incentives, and both these objectives were achieved in the Federal incentive income-tax plan which we introduced to Congress in 1945, and which we continue to advocate. During the past 12 months, however, we have come to realize that even more important than simplification of the tax structure and provision of incentives is the necessity for the Federal Government to level off the present inflation.

Inflation can never be leveled off by increasing taxes, no matter how the taxes are distributed, whether in a hodgepodge of income taxes, corporation taxes, and excess-profits taxes as at present, or by using a new tax, such as a sales tax, to take up part of the load.

We know that many persons assert that high taxes prevent inflation, by mopping up purchasing power, but the record of the 5 years since World War II should be enough to disprove this.

Senator KERR. Let me ask a question about this, Mr. Main: Suppose you had governmental income of $60 billion and suppose that your budgetary requirements for domestic and defense expenditures are $75 billion.

Is it more inflationary or less inflationary to secure that additional $15 billion by the selling of bonds or borrowing the money, or by increasing the tax take to $75 billion and thereby fixing it so that that additional billion dollars of spending power which, if not taxed, would be in competition with the Government, but which if taxed would be used to get the funds with which to pay for that additional $15 billion in expenditures, instead of creating the new money, which is what you do when you issue bonds and get it that way—which of those two would be more inflationary or less inflationary?

Mr. MAIN. It would be more inflationary to increase the taxes and, as we go along, I think that we can explain that.

Senator KERR. All right. You are going to have quite a job selling me on that——

Mr. MAIN. I realize that, because our viewpoint is entirely contrary to the accepted belief, if we might call it that, that high taxes mop up inflation. As we go along, I think that we will begin to answer——

Senator KERR. I do not subscribe to the view that high taxes alone are anti-inflationary, and I did not ask you a question based on either the accuracy or the inaccuracy of that principle.

I asked you a question based on the alternative method of securing the additional money which we will assume, for the purposes of this question, the Government must have.

Mr. MAIN. In times of emergency, where it is necessary to have more money than can be taken out without puffing up the national income, it is less inflationary to borrow in our opinion.

Senator KERR. It is your opinion then that it would be inflationary to leave that additional $15 billion of purchasing power in the hands of citizens with which they can be trying to buy production that did not exist, and then have the Government issue $15 billion in new money to be competing against that excess purchasing power which the people have to buy products with, which are either in limited supply, or nonexistent.

You think that is less inflationary, then—in other words, you think it is less inflationary to have $80 billion with which to buy $15 billion worth of goods; is that what you are saying?

Mr. MAIN. In our opinion, there is no surplus or untapped reservoir of income which can be taken without increasing costs.

Senator KERR. That is another question.

Mr. MAIN. We do not believe that it is possible——

Senator KERR. That was not the question I asked you. I asked you which was less inflationary if the Government has to have an additional $15 billion worth of money, whether it should be obtained by the Government's issuing new money, or whether it should be obtained by the Government's taking that amount of money presently available to people who, unless it is taken from them, will use it to buy those same products.

Mr. MAIN. Well, if it was possible to take it without inflation, I would prefer to take it.

Senator KERR. I do not think it is possible to use it either way without inflation.

I did not ask you that. I asked you which would be less inflationary.

Mr. MAIN. The borrowing would be less inflationary.

Senator KERR. All right. I am going to listen to you now with great interest to see how you demonstrate that.

Mr. MAIN. All right.

During this period the Federal tax take was at the highest point in history—even higher than during World War II.

Senator KERR. Was it higher percentagewise?

Mr. MAIN. Yes.

Senator KERR. Be very careful about that because I am going to cross-examine you on that.

Mr. MAIN. I am ready.

Senator KERR. What was the national income in 1945?

Mr. MAIN. In 1945?

Senator KERR. You said you had an expert here now to help you answer these questions.

Mr. MAIN. I think the national income in 1945 was about $160 billion. Mr. Conick will know.

Senator KERR. Let us get it because I am going to find out how much you know or how little I know.

You understand that you have said that during the period since World War II the Federal tax take was at the highest point in history, even higher than during World War II, and I asked you if that was correct percentagewise, and you have said, "Yes."

Mr. MAIN. I think it was about 17 percent.

Senator KERR. I say, you have said "Yes"; is that correct?

Mr. MAIN. We give the figures a little later.

Senator KERR. I say, Am I correct on that?

Mr. MAIN. Yes; that is right.

Senator KERR. All right. That is fine.

What was the national income in 1945?

Mr. CONICK. $182.6 billion.

Senator KERR. $182 billion?

Mr. CONICK. Yes.

Senator KERR. What was the total tax take that year?

Mr. CONICK. The net receipts were 44.7 billion.

Senator KERR. What do you mean, "net receipts"?

Mr. CONICK. You report—the Government reports net receipts and total receipts. Net receipts were 44 billion.

Senator KERR. What were the total receipts?

Mr. CONICK. 47.7 billion.

Senator KERR. 47 billion?

Mr. CONICK. Yes, sir.

Senator KERR. That net was derived from rebate of taxes that were overpaid?

Mr. CONICK. Yes, sir.

Senator KERR. That did not affect the tax in the 47 billion because of the fact that they took part of it and paid it back, paid back what they overpaid, in the form of rebates for previous years; is that not correct?

Mr. CONICK. That is right.

Senator KERR. All right. Now, what percentage is 47 billion 750 million of 182 billion?

Mr. CONICK. About 30 percent.

Senator KERR. How much?

Mr. CONICK. About 30 percent. I beg your pardon. Just a moment.

Senator KERR. I would figure 30 percent about 54 billion. I am not a certified public accountant, but I can figure that.

Mr. CONICK. About 26 percent.

Senator KERR. That is fine. That is the way I would figure it.

What was the 1950 total income?

Mr. CONICK. The national income in 1950 was about 239 billion.

Senator KERR. Would you say 240 billion, roughly?

Mr. CONICK. I think so.

Senator KERR. What was the total tax take?

Mr. CONICK. The total tax take?

Senator KERR. In 1950.

Mr. CONICK. The total receipts were 41 billion; net receipts 37 billion.

Senator KERR. Forty-one billion was the same figure we used awhile ago; was it not?

Mr. CONICK. That is right.

Senator KERR. What percent is that of 240 billion?

Mr. CONICK. About 17.

Senator KERR. About 17 percent. Well, then, 17 is not nearly 26; is it?

Mr. CONICK. Senator, I do not think it is fair to take 1 year.

Senator KERR. I say, 17 percent is not nearly 26 percent; is it?

Mr. CONICK. No, sir.

Senator KERR. Then, the take for 1950 percentagewise was not higher than it was percentagewise during World War II; was it?

Mr. CONICK. That is 1945 as against 1950, but if you take the war period from 1940 to 1945, and the period from 1946 to 1950, you get a different story.

Mr. MAIN. The total tax——

Senator KERR. 1945 was the last war year; was it not?

Mr. CONICK. We took 1 year instead of the total.

Senator KERR. I say, it was; was it?

Mr. CONICK. Yes.

Senator KERR. What was it in 1944?

Mr. CONICK. It was 183.8, national income.

Senator KERR. All right. What was the total tax take?

Mr. CONICK. About 44 billion.

Senator KERR. 44 billion? Is that the total?

Mr. CONICK. 43.0 billion is the net, and 45 is the total.

Senator KERR. What was the total? That is the figure that we have been using.

Mr. CONICK. Forty-five.

Senator KERR. All right. What percentage of 183 is that?

Mr. CONICK. Senator, I have it worked out for the 5 years.

Senator KERR. I am cross-examining you.

Mr. CONICK. I will make the calculation.

Senator KERR. He said you were an expert.

Mr. MAIN. I said he was the executive partner in Main & Co.

Senator KERR. Well, you said he was here to help you answer questions.

Mr. MAIN. That is right, and he has shared in the preparation of the statement.

Senator KERR. All right.

Mr. CONICK. About 25 percent.

Senator KERR. Was the national income in 1945 as much as it was for 1946?

Mr. CONICK. In 1946 it was——

Senator KERR. I mean in 1944 was it as much as it was in 1945?

Mr. CONICK. It was more.

Senator KERR. It was more in 1944 than it was in 1945?

Mr. CONICK. Slightly.

Senator KERR. All right. In 1944 the tax take was 25 percent?

Mr. CONICK. About 25 percent.

Senator KERR. All right. What was the national income in 1949?

Mr. CONICK. 216.8 billion.

Senator KERR. What was the Federal tax on that?

Mr. CONICK. Total receipts were 42.7 billion.

Senator KERR. What is that percent?

Mr. CONICK. About 20 percent.

Senator KERR. About 20 percent.

Thus far, percentagewise 1944 was 25 percent, 1945 was 26 percent, and 1949 was 20 percent; 1950 was 17 percent. We do not have it higher percentagewise yet than it was in World War II, have we?

Mr. CONICK. Not for those 2 years.

Senator KERR. All right. What was 1943?

Mr. CONICK. National income was 169 billion.

Senator KERR. What was the Federal tax take that year?

Mr. CONICK. The total receipts, we are figuring on total, not net——

Senator KERR. Yes, sir.

Mr. CONICK. Total were 23 billion 402 million.

Senator KERR. All right.

Mr. CONICK. About 14 percent.

Senator KERR. Fourteen percent in 1943. What was the total in 1948?

Mr. CONICK. In 1948, 223.4 billion.

Senator KERR. In 1948 it was 223.4 billion?

Mr. CONICK. Yes.

Senator KERR. What was the tax take that year?

Mr. CONICK. Total receipts were 46 billion, about 20 percent.

Senator KERR. Now, let us add those 3 years together, and let us add the total income for 1943, 1944, 1945——

Mr. CONICK. The total national income from 1943 to 1945 was 535 billion.

Senator KERR. 535 billion?

Mr. CONICK. 535 billion.

Senator KERR. What was the total tax take for those 3 years?

Mr. CONICK. 116.5 billion.

Senator KERR. What was that percentagewise?

Mr. CONICK. About 22 percent.

Senator KERR. Let us take the 3 years, 1948, 1949, and 1950.

Mr. CONICK. 676 billion.

Senator KERR. Does that include the—that is not total individual——

Mr. CONICK. Total national income.

Senator KERR. How much?

Mr. CONICK. I beg your pardon; 679 billion. These are round figures.

Senator KERR. Well, let us say 680 billion. What was the total tax take for those 3 years?

Mr. CONICK. 130 billion.

Senator KERR. What percentage is the of 680 billion?

Mr. CONICK. Just about 20 percent, or a little under; in round figures, 20 percent.

Senator KERR. Then certainly with reference to 1943, 1944, and 1945, when the tax take was a little over 22, and 1948, 1949, and 1950, when it was a little under 20, it has not been the highest percentagewise; has it?

Mr. CONICK. For those 3 years, it has not.

Senator KERR. All right.

Mr. MAIN. We based our calculations on the entire war period, and the 5 years after the war period.

But, as you gentlemen well know, inflation is worse today than at any time since the turn of the century.

As opposed to such a fallacious theory, we would ask you to consider what we call the law of the take. This, very simply, is that the Federal Government can take any amount of taxes it desires—whether the $71.6 billion requested by President Truman or $80 billion or $90 billion or $100 billion—but that an excessive take automatically puffs up the national income; in other words, causes inflation.

We ask that you think on that carefully, because we believe it explains a very surprising change in public attitude in recent years. The American public used to be very much opposed to payment of Federal taxes, but seemed to show little concern at the size of the Federal debt. An increase in taxes was a thing a man felt directly in the region of his pocketbook; public debt was something the economists talked about, but beyond the comprehension of the so-called man in the street. Now, suddenly, everyone seems debt-conscious and says learnedly that we should "pay as we go."

But, except for a bit of grumbling at the time a tax jump is mentioned, most of our people seem convinced that they can take such increases in stride.

If this meant that each taxpayer planned to pull in his belt a bit tighter, or to tap surplus funds to carry him through, increased taxes might have some effect in lessening inflation. But things are not working out that way. Most of our people have a slim margin between a comfortable life and what they consider a mere existence. The reason they don't grumble more about increased taxes is that they have found a cushion to absorb the blow.

That cushion, of course, is inflation, which puffs up the national income in dollar terms out of all proportions to goods produced and services rendered. The man hit by excessive taxes passes them on, in one way or another, by a higher price for his labor. The business hit by excessive taxes hands them on through higher prices for its merchandise or services. Because this has gone on again and again, the belief seems to exist in many quarters that it can go on forever.

If everybody received double wages, doubling the cost of living would not be too bad. But we know that it does not work that way. Many are confronted with increased living costs and with no compensating increase in revenue. For the elderly, and all others on fixed income, the situation already approaches catastrophe.

From the practical standpoint of Congress, as it seeks to provide for the Government's needs, each additional degree of inflation lessens the purchasing power of the tax dollar. Thus an excessive tax take which, as we have said, increases inflation, defeats its very own ends and at the same time endangers our whole economy.

There have been many warnings lately that we are "approaching the danger point" in taxation. We believe that point is past, and that the danger becomes greater each day the present inflationary trend goes unchecked. A tax take becomes excessive and dangerous when it either destroys incentives to produce, to save, and to invest, or when the tax is passed on as part of an inflationary spiral. So far the latter condition has obtained and production has increased. But at the same time investments in new and risk-taking ventures have fallen off.

When our people feel that their dollars are losing value, they rush to exchange them for goods, causing undue pressure on our production facilities. The buying spree of last fall, and the slump that followed in many fields, are warning signals of the dangers of inflation.

An alllowable tax take, one that will not add to inflation and may cause it to level off, is certainly not more than 17 percent of the national income.

Senator KERR. How do you arrive at that figure?

Mr. MAIN. We arrived at that through the experience of this country and through studying what had happened in other countries. I might say this, if I can take the time, that in 1945 when we presented what was known as the Federal incentive income tax plan, it was presented as a result of 2 years' study, and it was in April 1945, when we were still at war with Japan and Germany.

At that time all the other plans were based on a postwar revenue of a hundred billion, which was much in excess of what we had prior to 1941.

Senator KERR. Postwar revenue?

Mr. MAIN. It was based on a postwar national income of a hundred billion.

Senator KERR. Let us stop right there.

Mr. MAIN. And a Federal budget of 16 to 18 billion.

Senator KERR. I say, would you just let me ask you a question?

Mr. MAIN. Pardon me, Senator.

Senator KERR. Was it your considered judgment in 1945 that postwar national income would be $100 billion?

Mr. MAIN. $160 billion. We were the only—

Senator KERR. I thought you said it was based on a postwar income on $100 billion.

Mr. MAIN. We said all other plans of that day were based on a $100 billion postwar.

Senator MARTIN. Mr. Main's group, Senator Kerr, felt that it would be $160 billion.

Mr. MAIN. 160 billion.

Senator MARTIN. That is what they claimed. All of us thought you were off the thing. I used to argue it with Mr. Main and I just thought that was all silly to think of 160 billion, because it would be so inflationary—that was my argument.

Go ahead. I am sorry.

Mr. MAIN. I said the postwar budget would be at least 25½ billion. We were accused at that time of advocating waste in Government, because all the other plans were 16 billion to 18 billion.

Our arithmetic said it would be at least 25½ billion, and we reasoned that it would be impossible to carry 25½ billion with a postwar national income of 160 billion.

Senator KERR. I thought you just said that would be the reasonable amount to expect on the 160 billion.

Mr. MAIN. We said that it would be at least 160 billion.

Senator KERR. And that 17 percent was a reasonble percentage.

Mr. MAIN. Yes, sir.

Senator KERR. And that 17 percent of 160 billion would be 25 billion?

Mr. MAIN. Yes, sir.

Senator KERR. Approximately?

Mr. MAIN. Yes. We based it on 25½ billion.

At that date, the New York Sun of June 1, 1945, had an editorial on our proposed plan, and commended a private citizen for interesting himself in this problem, but said in polite words that it was out the window because there could never be 160 billion in the postwar period.

Senator KERR. I want to commend you not only for taking the interest, but having the interest and doing the work in making the estimate, and I want to commend you for being one man who was not hamstrung by pessimism in trying to gage the future by specifications of the past.

But you are happy to have lived to see that even your most optimistic estimates may now be considered as having been conservative.

Mr. MAIN. Yes.

Senator KERR. All right.

Mr. MAIN. Thank you, Senator; thank you for your commendation, because, in those days, as Senator Martin knows, we had plenty of criticism on every side, and Mr. Stam was familiar with what we were doing at that time. I will say this, that Mr. Stam never criticized our estimates, at least to us.

Senator KERR. Well, Mr. Stam has a record that has proven him not only to be one of the ablest, but one of the most effective diplomatic public servants that I know of. [Laughter.] He has demonstrated that he can get along not only with this committee, but even with the House Ways and Means Committee, and with the run-of-the-mill taxpayers, and that is something.

Mr. MAIN. We have had a great deal to do with Mr. Stam and we commend him most highly.

Senator KERR. Fine.

Mr. MAIN. This is much lower than the present take; it is much lower than many people believe can be taken without causing inflation. But a 17-percent take is safe only with an entirely different tax structure, such as the Federal incentive income tax plan.

With reference to budget requests before you, we urge that Congress lop off every item that does not contribute directly and provably to defense or to efficient Government operation. Federal departments have no more excuse than any individual for unnecessary spending. It is our belief that approximately 9 to 10 billion dollars could be cut from the President's proposed $71.6 billion budget.

To such an extent that anticipated revenue from taxes, on either the present or on a lowered basis, does not meet the needs of your curtailed budget, we recommend that you allow the difference to stand as an increase in the national debt.

This contradicts the present belief that we must "pay as we go," but we consider it the least inflationary plan under present circumstances.

Debt, whether of a nation or of an individual, is to be avoided whenever possible, but is dangerous only when it becomes too large in relation to anticipated income.

Our national debt of approximately $257 billion seems high in comparison with the 1941 prewar $49 billion, but largely represents the cost of fighting and winning World War II without bankrupting our economy.

Senator KERR. You take some comfort in the knowledge that it is now about 252.5?

Mr. MAIN. Yes.

It largely represents the result of fighting and winning World War II without bankrupting our economy. It is not a dangerous level for a Government with a present national income at the rate of $269 billion or the $300 billion we expect to reach in the not too distant future.

Senator BYRD. Suppose the national income went down, what then?

Mr. MAIN. Well, the national income is bound to ebb and flow. The economic forces are like all tides, they ebb and flow, so that there is nothing which ever moves in a straight line.

Senator BYRD. What you are stating seems to me to be the wrong premise. You are taking the debt, which seems to be a stationary figure, unless we pay it off, and saying it is all right to have that debt if the national income continues to rise. Suppose the national income does not do it, then is the debt dangerous or not?

Mr. MAIN. From our studies we believe there will be current ebbs and flows in the national income. We do not believe that there can be any great inflation; we do not believe there can be any great deflation with our present wage level, which is going to go higher, in our opinion——

Senator BYRD. That was what everyone believed in 1929; was that not true?

Mr. MAIN. Yes.

Senator BYRD. Ninety percent of the country believed it in 1929, and we had one of the worst collapses and depressions that we ever had.

Mr. MAIN. Certain of the wages went down, but many of the wages, Senator, did not go down.

If we take the cost of manufacture, the cost of services, and we add to that the cost of taxes, we add a very definite load.

Senator BYRD. In other words, you see ahead of us a permanent level of high prosperity; is that right, or not?

Mr. MAIN. I do not say that inflation means prosperity, Senator.

Senator BYRD. I know, but you are basing our debt on the income, the national income, which is now at an inflationary level. You say that that debt is not dangerous at that level. Well, I contend that that is not sound logic because that level may change, and that it will change.

Mr. MAIN. Senator, in 1946 there was a point, as I recall it, when the national income was $180 billion. At that time the debt represented 2 years' national income. At the present time our debt represents less than 1 year's income, and as our inflation continues, the debt is being reduced.

Senator KERR. Mr. Main, you may be losing the chairman, but you are very rapidly getting one of the members in your corner. You are getting him very rapidly. [Laughter.]

Senator BYRD. That is the first time I have heard it suggested that the debt is not undesirable. You are apparently——

Senator KERR. He did not say that.

Senator BYRD. He says it is not dangerous.

Senator KERR. He calls attention to the fact that we have arrived at the position where our national income per year exceeds our total debt, and what he is saying to you is that we are in a healthier position by far insofar as the national debt is concerned when our annual income is 20 percent above the total national debt than we were when our annual income was about half of the national debt.

Senator BYRD. I still say that is on the presumption that the national income will continue either at the present level or rise higher; that as the national income goes down, then your logic is not sound. Never in the history of this country have we had long periods of prosperity without some dips and depressions, some very serious and some not so serious, and this national income is based on inflation——

Senator KERR. We will have some dips.

Senator BYRD. Because the dollar today will only purchase 52 cents as compared to 1940, and in the building trades it only purchases 40 cents. So we will have an inflationary basis which will go so high that it may collapse.

Senator KERR. I want to join this witness in saying that the trend is up, and that we will be on a national income of $400 billion before we will ever be back——

Senator BYRD. That is the most dangerous condition if based on an increasing inflation.

Senator KERR. Let me finish.

Senator BYRD. If we go up by inflation.

Senator KERR. Let me finish. Let me finish making the prediction—we will be at a national income of $400 billion before we will go back to an income of $200 billion.

Mr. MAIN. I agree with you.

Senator BYRD. None of us know; this is all conjecture.

Senator MARTIN. I would like to know how high will the income go when we have the blow-out at the top?

Senator KERR. We are not going to have the blow-out at the top.

Senator MARTIN. Wait a minute. One of the greatest countries in the world was Germany. The people had the know-how, they were educated, they were industrious, they were thrifty, and still they had it, and I am taking that as an illustration. I have great admiration for Mr. Main. He has done a lot of grand things.

Senator KERR. I am having more and more as I go along.

Senator MARTIN. I have a great deal of admiration for him, but I do not agree with him at all.

Of course, he and I have had many arguments. I do not agree with him at all; but I would like for you to venture the prophecy of how much will our income be when we blow out at the top like Germany did.

Mr. MAIN. I think that the time may well come when, if something is not done, if sound efforts are not made to level off inflation, I am looking forward to the time when our income will reach a trillion, and I might say [laughter]——

Senator MARTIN. But it will be an inflationary income.

Mr. MAIN. Yes, sir; absolutely; we have got an inflated income now.

Let us look for just a minute at what happened in France after the First World War. France won the First World War. Of course, we helped, I mean, and the Senator was a valiant soldier in that war, but we came in rather late.

Senator MARTIN. I will not get into that argument.

Mr. MAIN. That is true, Senator Martin, that you and I have been friends——

Senator BYRD. You will not deny that.

Senator MARTIN. But I feel that it was a great economy, the soundest economy of the United States that won World War I and World War II.

Now, then, I want to keep us a sound economy, so that we can win world war III if we are unfortunate enough to get into it. That is what I am interested in.

Mr. MAIN. Let me just finish now and tell you what happened in France.

At least, the French helped win that World War, and they made——

Senator MARTIN. The Frenchman is a great soldier, there is no question about that——

Mr. MAIN. The franc prior to the First World War——

Senator MARTIN. But France was licked and so was Great Britain——

Mr. MAIN. Until we got into it.

Senator MARTIN. Until we got into it.

Mr. MAIN. I agree with that.

The franc was worth 20 cents prior to World War I. A good job was done in controls in France, because in 1919 the range of the franc was from 18 cents to 9 cents. That meant that they had held the franc very well. Nine cents meant a hundred percent inflation, because we are looking at it from the reverse.

France wanted security; they wanted to help their neighbors; they wanted to do a lot of things, and they did a lot of things, and they built the Maginot Line, and the franc kept on going down, and I think it was in 1925, Senator, and if I am wrong in that date, please excuse me—I think it was 1925 that the French Parliament passed a law stabilizing the franc at 3.92. That is practically a 500 percent inflation.

Of course, unfortunately, these economic laws do not understand French or they do not understand any language except their own language, and the franc now, of course, due to other circumstances, is worth just a fraction of a cent.

It would be a fine thing if it were possible for a government to do all that it wanted to do, to be a Santa Claus, and give out all good things. But a government cannot do it because when they take more than a certain percentage of the national income, inflation results, and the income is puffed up.

Shall I go on?

Senator BYRD. Yes.

Senator MARTIN. Mr. Chairman, I am awfully sorry, but I am one-half hour late for another meeting, and, Mr. Chairman, I will have to be excused.

It is most unfair to——

Senator KERR. Mr. Main, I want to tell you that I am one man on the committee who agrees with part of what you have to say, and I am going to stay and listen to the rest of it.

Mr. MAIN. Mr. Chairman, I would just like to express to you again my friendship for Senator Martin over 30 years, and I want to say that we often disagree, so that I do not think that the friendship is based on agreement.

Senator MARTIN. Off the record.

(Discussion was continued off the record.)

Senator BYRD. I am sorry that I must leave, Mr. Main. I will read your colloquy with the Senator from Oklahoma in the record.

Mr. MAIN. Yes, sir.

Senator BYRD. There is just one more comment that I want to make about national income and get your consideration of it.

I think a national income that is based on inflation is a very dangerous standard to take. I would be much more convinced of what you say if you based your premise on national production, but these things that were sold for a dollar in 1940 are costing in terms of articles and not in actual dollars twice that much now, and you are putting it on a dollar basis instead of putting it on a national production basis of material and so forth, and you are saying then that this debt that we now have can be carried safely on that, not knowing how much further inflation we are going to have.

It is perfectly possible that in the next 10 years the dollar is only going to be worth 25 cents compared to 1940. If we go down as much in the next 10 years as we went down in the past 10 years, the American dollar will be worth only 25 cents in purchasing power as compared with 1940. You do not question that?

Mr. MAIN. No. Our Federal debt will be worth very little in that event.

Senator BYRD. I know, but some day the Federal debt has got to be either paid off or we must continue to pay the interest, and it may have to eventually be paid off in dollars having much more value than they have today, and the Government may have to do that. That is the fallacy, if you will permit me to say it, of what you have said, that this national debt is nothing to worry about, on account of an income which is an inflated income, not a natural income, not a normal income, but inflated under certain conditions that have occurred since the last war.

I just wanted to express my thought on that.

It might not be worth anything at all——

Mr. MAIN. Thank you very much for your courtesy.

Senator BYRD. I regret that it is necessary for me to leave. You converted this gentleman here on my right.

Mr. MAIN. Not entirely. Nobody agrees entirely with us, Senator, and that is one reason we think that we may be partly right because nobody agrees entirely with us.

Senator BYRD. I would like to put Senator Kerr in charge of the committee at this point.

(Senator Kerr assumed the chair.)

Senator KERR. All right, Mr. Main, you go ahead and finish your statement.

Mr. MAIN. In fact, we can think of no better yardstick of allowable debt than the amount of national income in one year.

To summarize, an excessive tax "take" cannot help but cause inflation. The "take" is already excessive and any increase will add to the present dangerous inflation. We urge that the Finance Committee use its influence to avoid any increase in the "take." After the budget is cut as much as practicable, we recommend that the Government temporarily borrow any sums required.

It was my understanding and intention to have Mr. Conick follow me.

Senator KERR. All right, sir.

Mr. MAIN. If that is all right with you.

Senator KERR. All right, Mr. Conick.

Mr. CONICK. My name is M. C. Conick, and I am an executive partner of Main & Co., Pittsburgh.

Your committee has before it at present, the House bill, which, it is estimated, will add about $7 billion to the tax "take." We think this is a low estimate of its yield. And there are indications that if this becomes law, requests will be made for more or other new taxes. Comments are being made that the income tax has been "milked dry" and that what is needed is some other kind of a tax, such as a general sales tax, to spread the burden.

We declare that the burden is already excessive and no manner of distributing it can prevent the operations of the "law of the take."

From 1922 to 1930, Federal spending averaged approximately $3,500,000,000 a year and receipts averaged $4,000,000,000. Between 1931 and 1940, when deficit financing was being utilized as a depression antidote, Federal spending rose to an average of $7,000,000,000 yearly, or about 11 percent of the national income. Receipts, however, accounted for only an average of $4,000,000,000 yearly, a "take" of 6½ percent of the national income, so that the Federal debt was allowed to rise from $16,000,000,000 in 1930 to $49,000,000,000 by the time we entered World War II.

Taxes rose to unprecedented levels, the net Federal "take" being 17 percent of national income, or nearly three times the prewar percentage; that is, taking the years of 1941 up to 1945.

Presumably Congress at that time believed that such taxes were as high as our economy could stand, for they allowed the Nation to go in debt for the balance of our needs, the Federal debt zooming up to $257,000,000,000.

During the war, public sentiment backed very tight controls, as well as very high taxes, so that inflation was fairly well restrained. Prices were held at reasonable levels. But when the fighting was over and the war ended and controls were relaxed, the pent-up inflation was unloosed.

Senator KERR. Would you say the pent-up demand was unloosed that resulted in inflation?

Mr. CONICK. I think that is a better word than inflation.

Senator KERR. All right.

Mr. MAIN. That is right.

Mr. CONICK. In April 1945, when we first presented to Congress our proposed Federal incentive income-tax plan, the United States was at war with both Germany and Japan. For the postwar period we estimated a national income of $160,000,000,000 and a Federal budget of $25,500,000,000 which would have required a tax "take" of about 16 percent of the national income. Other plans of that day were based upon an estimated income of $100 billion and a Federal budget of $16 to $18 billion, a consequent tax "take" of about 17 percent.

We were criticized for our high forecasts, but insisted that the budget of $25½ billion was inevitable and that it could not be taken from a national income of less than $160 billion. As you are aware, both national income and Federal budgets have climbed far above our then high estimates, in dollars as well as in the percentage of tax "take."

During 1950, the national income reached a total of about $239 billion. At present it is over $269 billion. If all this were represented by increased national production, we might all be proud. But through the operation of inflationary factors including the "law of the take," it is largely a puffed-up income. We become aware of that whenever we pay $2 for meat for which we formerly paid $1 or when we pay $6.98 for a shirt for which we formerly paid $3.50. The Government becomes aware of it when it pays out an increasing number of its tax dollars for each gun, tank, or plane it requires for the defense program.

If, as many persons would have us believe, high taxes prevent inflation, the inflation caused by World War II should have been leveled off or at least slowed down by now. For the net Federal tax "take" in the 5 years since the war has been 19 percent; even higher than the 17 percent during the war.

Based on our present rate of national income of more than $269 billion, President Truman's proposed budget of $71.6 billion, if financed on a pay-as-we-go basis, would represent an unprecedented Federal "take" of 26.6 percent. Under the operations of the "law of the take," it would result in further drastic puffing up of the national income.

Bearing in mind that an excessive "take" automatically puffs up the national income, in determining a safe tax "take" we must first determine how much more puffing-up can be risked without too great a danger to our economy.

It goes without saying that the Federal Reserve Board and the Treasury Department should agree on sound fiscal policies, but even these policies cannot offset the price-raising effect of a too drastic tax "take." Such taxes automatically boost costs, both directly and indirectly, and these, in turn, determine prices.

We believe it is relatively safe to risk the further rise of national income to as high a level as $300 billion, in which case there will be $48 billion, or more, of corporate compiled net profits before taxes. Under such conditions a tax "take" of $58 billion, or approximately 17 percent, can be borne, we believe. But we do not believe that even such a burden can be borne under the present hodge-podge tax structure.

The next remarks will be made by Mr. Main, and if you will bear with him, he will conclude his paper.

Senator KERR. Go ahead.

Mr. MAIN. We were supposed to have a certain amount of time—

Senator KERR. That is all right. We were responsible for part of the increased time.

Mr. MAIN. We appreciate it very much, Senator Kerr.

Senator KERR. So it may be we have taken some of your time as well as your having taken our time.

Go ahead.

Mr. MAIN. There has been considerable discussion of late to the effect that the income tax has outlived its usefulnesses and must be supplemented by some new kind of Federal tax, such as a general sales tax.

We feel that an income tax, properly applied, is the fairest form of taxation yet devised. It is the easiest to collect. But the original act of 1913 has been so patched up and so supplemented by an excess-profits tax, a corporation tax, and taxes on dividends and undistributed surplus, that our tax system now serves as a series of penalties, rather than as an encouragement to greater efforts.

We are subjected to: (1) An income tax so drastic as to penalize hard work; (2) an excess-profits tax penalty for skilled management; and, (3) a dividend tax penalty for investing in productive enterprises.

Added to these, a general sales tax would constitute a fourth penalty, one on the purchase of any goods produced, and thus would extend the effects of the penalties to the last humble household.

We have long felt that what is needed is an entirely new system, based on the income-tax principle, but designed to encourage production rather than to penalize it at every turn. It is generally recognized that greater production is our only means of protecting ourselves against enemies overseas and of counteracting inflation at home.

Our limited time, and yours, does not permit us to give an adequate discussion of our proposed Federal incentive income-tax plan, but we should like to take a minute to indicate its salient features. This plan is the result of careful thinking by men who have spent most of their lives working with tax accounting, and other economic problems of corporations and individuals.

We believe that time has confirmed the soundness of its principles.

Reduced to simplest form and terms, the Federal incentive income tax plan is: (1) Taxes income as income, whether received by an individual, partnership, or corporation; (2) fixes exemptions as high as possible, in order to leave as much income as practicable under the taxpayer's own control; (3) has a graduated-rate structure, rising to a maximum of 50 percent of taxable income; (4) eliminates such double and therefore unfair taxes as those on dividends and on undisturbed surplus.

As mentioned, this plan places a maximum tax on corporations and individuals of 50 percent of net taxable income. It eliminates the excess-profits tax, a source of countless inequities every time it has been imposed and a cause of much wasteful and extravagant spending under the theory that "otherwise the tax collector will get it."

Because the rates of the Federal incentive income-tax plan are so much more reasonable than those in the House bill—in which some corporation profits are taxed as high as 83 percent—with an over-all limitation of 67 percent—it is logical for you to wonder if the plan will produce the funds required for our defense needs and for other Government necessities. Our answer is that, with some sensible budget trimming and some temporary borrowing, it will, and with the present miscellaneous revenues.

We are not attempting to touch the excises or the estate taxes, or customs, or any of the miscellaneous revenues.

An even stronger answer is that the Federal incentive income-tax plan with the rates proposed, will produce the greatest revenue possible without forcing inflation to new and ever more dangerous heights.

Details of the plan are given in a leaflet which has been placed on your desks. We shall, of course, be pleased to give you any other information you may require.

Senator KERR. Well, thank you very kindly, Mr. Main.

I must say that there are some of the statements that you made that I agree with thoroughly.

I think personally your statement is very provocative. I would be glad to study your plan, but I cannot get away from the basic disagreement I started out with you on, and that is, if you have to have an additional amount of money, and if a situation exists where the production is limited, the inflationary pressure of taking the money which would otherwise be used to spend for what you have to have, and using it to buy what the Government has to have, the inflationary pressure will be less than if you leave it in the hands of the people who seek to use what is available and the Government, at the same time, issuing new money, which would compete with the money in the hands in which you leave that amount of purchasing power.

Mr. MAIN. I am only in favor, Senator, of borrowing when we are under an extreme emergency. I am not in favor——

Senator KERR. I am only in favor of borrowing when we cannot get it otherwise.

Well, I want to say that I have enjoyed what you said very much. I am sorry you took as much time as you did, but we had a good time here.

Mr. MAIN. If you go into it, and if you find any questions, if you will drop us a line, we will be glad to furnish you with the information.

We have carried on this research for 8 years. We have a lot of data and if what we have will be of any help, we will let you have it.

Senator KERR. You are very kind. I want to say you have given me enough to keep me busy for a while.

Mr. MAIN. Thank you.

Senator KERR. We will recess now until 10 o'clock tomorrow morning.

(Whereupon at 1:10 p. m., the committee recessed to reconvene at 10 a. m., Wednesday, August 1, 1951.)

REVENUE ACT OF 1951

WEDNESDAY, AUGUST 1, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry F. Byrd, presiding.

Present: Senators Byrd, Connally, Hoey, Kerr, Frear, Millikin, Martin, and Williams.

Also present: Elizabeth B. Springer, chief clerk, Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. The committee will come to order.

Our first witness is Mr. John Fitzpatrick.

Senator HOEY. Mr. Chairman, before the witness begins his testimony, the other day Mr. John W. Hanes, president of the Ecusta Paper Co., of North Carolina, testified, and at that time Senator Taft wanted some additional information, and Mr. Hanes said that he would write a letter giving that additional information and additional facts.

I would like to present that, and ask that it be incorporated in the record.

Senator BYRD. It will be incorporated in the record.

Senator HOEY. Together with the supplementary statement of Mr. Hanes?

Senator BYRD. Yes.

(The documents referred to will be found at the end of the presentation heretofore made by Mr. Hanes at p. 1677.)

Senator BYRD. All right, Mr. Fitzpatrick.

STATEMENT OF JOHN F. FITZPATRICK, MAYOR, BOROUGH OF SOUTH RIVER, MIDDLESEX COUNTY, N. J.

Mr. FITZPATRICK. Mr. Chairman and members of the committee, the residents of the borough of South River, N. J., join with me in extending our thanks and appreciation to you for arranging for this conference and permitting me to say a few words in opposition to the proposed tax upon our municipally owned power and light plant. I am filing with your secretary a short written memorandum containing some of our objections to the proposed legislation. May I supplement that with a few words?

South River is a small town—less than three square miles in area. It has a population of about 10,000 people.

We are not blessed with a single large industry with high ratables. We have only a few small factories in the needlework industry, giving employment mostly to women. The male population gets its employment in nearby communities, making South River virtually and truly a residential town for working people, blessed with large families of children.

It is certain that our number of school children is greater than that of any other municipality in our county in proportion to adult population.

Therefore, our general public-school expense is very high and realizing that we could not look to income from large industries, we built our electric light and power plant some years ago principally to assist in meeting school expenses. These expenses are constantly growing. Extensive repairs are needed to some buildings, and the erection of new school buildings is rapidly approaching a necessity.

To lose any part of the revenue of our electric plant is more than can be afforded. Such loss will have its effect upon our schools as they now exist, and will delay further expansion.

If the proposed tax is levied against the funds collected from the sale of light and power to our residents, we will lose about $12,000 a year. This is money we have earmarked for payment of interest and for bond retirement. This is money we are depending upon, and in a small community every thousand dollars is mighty important.

Thank you again for permitting me to appear here.

We earnestly hope that the proposed tax levy will not be enacted into law.

Gentlemen, may I say again that during trying times, the only thing that kept this small city going in the heart of Middlesex County, was our needle industries, as far as the women are concerned.

We have surrounding towns with large industries, such as du Pont, Titan, Johnson & Johnson, and there is a struggle; for instance, now we are trying to put in a large water line because a certain part of our borough needs more water pressure, and this little plant—an amount of money of $12,000 or $13,000 may not mean a thing to some people, and it may be just a drop in the bucket, but it means a lot to us.

I am down here—I know there is an old saying that perspiration is a cooling process. It was hard for me even to get a hotel room in this Capital of ours last night. However, I am here, and I want to get back to an underprivileged camp of which I am in charge, and I just want to bring this up to you, that none of us are paid. We do not get any salary, and sometimes we wonder why we more or less take the punishment as officials.

I want to say it is no more than civic pride. We are a small community as stated here, of 12,000, and I feel that—I understand Senator Smith's office—this bill has been from the House floor, and I ask you men, without taking a lot of your time because I see you are going to have quite a number of witnesses here today—I wish you would keep this bill out so that we can save this twelve or thirteen thousand dollars, because we are going ahead and trying to give this little town a good administration, and we do not have many industries to see our way through.

I want to thank you gentlemen and Mrs. Springer for the wonderful cooperation I have received in correspondence and telegrams and all, and I want to say that everyone has been very fine about it and I want to thank you all very much.

Senator BYRD. Thank you, sir. Your statement will be made a part of the record.

(The memorandum referred to follows:)

STATEMENT OF JOHN F. FITZPATRICK, MAYOR, BOROUGH OF SOUTH RIVER, N. J.

The borough of South River, in Middlesex County, N. J., is one of those small American communities which, along with many of its counterparts, has been termed, perhaps not without justification, the backbone of the Nation. A municipality whose total area does not exceed three square miles and whose population is slightly less than 12,000 would indeed be honored in being so regarded.

Within its boundaries are ten churches of various denominations, five schools, a theater and two ponds where the kids seem to have a fine time during the summer months. It has two banks, three building and loan associations, the usual assortment of social and fraternal groups and two political parties, known locally as Democrats and Republicans, respectively. In addition to the foregoing assets, it lists the operation of a power and water plant which is owned by its loyal, hardworking taxpayers.

These facts are not enumerated in a spirit of jest or irrelevance, but I cite them to you in the hope that you will conclude from them that South River is primarily a residential community engaged, incidentally, in the business of selling water and power to as many consumers as possible. I would like you to know further that the figures show conclusively that the business is operated the way Americans like to see any business operated—at a profit. A major portion of the annual surplus is transmitted to the governing body of the municipality and is included in its annual budget as an item of revenue. I need hardly tell you that the sum so transmitted goes a long way toward paying for the operation and maintenance of our police and fire departments, roads, public buildings, and all the various housekeeping chores expected in a progressive municipality.

What would it mean to South River, whose total assessed valuations amount to $6,700,000, to have a 3⅓ percent excise tax imposed on gross sales by its power plant? Taking last year's gross sales, which amounted to $347,000, the loss in revenue to the borough would be in excess of $12,000. The latter figure may appear insignificant, but when it is considered in conjunction with other pertinent statistics it assumes an unavoidable importance.

Our local-purpose tax rate is $1.48 per $100 and a $670 loss in revenue is equivalent to a 1 point or 1 cent rise in the tax rate. Consequently, the imposition of the proposed excise tax would signify an approximately 18 point or 12 percent increase in our local tax rate.

My choice of terms may be questioned, but I am moved to state that such an increase would constitute an almost intolerable burden on the residents of this community. They, along with millions of others, are sorely pressed today to meet the current cost of living which, incidentally, all of us hope to see decline. Taxes—municipal, State and Federal—are an ever-present problem and no relief appears to be in sight. Indeed, the prospect seems to be a gloomy one in that we are told to prepare for new and increased imposts, and this hearing but confirms that fact.

In this instance it does not matter that the tax will nominally be imposed upon the municipality, because its effect will be noticed swiftly by a corresponding depletion in the individual taxpayer's assets. It is my opinion that the time has come for a measure of respite and stock-taking. The taxpayer has suffered increasing burdens with the passage of the years and vast amounts contributed by him have been nobly spent on the security of his country and in behalf of the less fortunate throughout the world. The taxpayer understands this and has gladly acquiesced in the expenditures. However, there must come a time when the American citizen will cease to confine his complaints to grumbling and will raise his voice, demanding a precise audit, and I am very much afraid that any delay in the process will not be tolerated.

Last year the borough of South River collected 94.11 percent of the taxes assessed by it on individuals, business, and industry within its jurisdiction. I consider this response, the best in our community's recent history, not only remarkable but intensely reflective of the honesty and purpose which composes the character of the average American taxpayer. In these circumstances, and in the light of the effect which the proposed tax would have on our municipal economy, I do not relish informing my neighbors that the Senate is determined to proceed with the proposed tax.

The sum of $12,000, which will be removed from the governing body's prime source of revenue, will depart irrevocably, and as mayor of the municipality I have no intention of asking the people of South River to supply the deficiency by assenting to higher assessments on their real and personal property.

I earnestly hope that statement of facts contained herein will receive the equally earnest consideration of this honorable body and that its eventual decision will be to exempt municipalities from the proposed tax—just as it has in the past.

Senator BYRD. Mr. Charles E. Oakes.

STATEMENT OF CHARLES E. OAKES, CHAIRMAN, SPECIAL TAX POLICY COMMITTEE, EDISON ELECTRIC INSTITUTE

Mr. OAKES. Thank you, sir.

My name is Charles E. Oakes. I live at Allentown, Pa., and am president of Pennsylvania Power & Light Co. I am appearing as chairman of the special tax policy committee of the Edison Electric Institute, a trade organization representing 82 percent of the privately owned electric utility companies. These companies will pay well over a billion dollars of taxes in 1951, and consequently, we are vitally interested in the tax measure now before you.

Senator BYRD. Sit down, sir, if you care to do so.

Mr. OAKES. Thank you, sir.

I am reading a summary, gentlemen, of the statement that is before you.

At your request I have filed my statement and accompanying charts with you. It is my purpose to summarize this statement briefly, and then with the aid of the large-size reproductions of the illustrative charts which you have before you, answer such questions as you may wish to ask. The complete statement with accompanying charts is submitted here to be printed in the official records.

The electric companies appreciate the difficult task confronting this committee, and we want you to know that we seek no special privilege apart from other industries in paying any additional taxes that may be required during the national emergency.

We believe that as far as possible national defense should be on a pay-as-we-go basis if inflation is not to destroy our American economic system. We also believe that with the heavy burden of present and proposed taxation, every effort should be made to remove inequities from our tax laws.

The elimination of the 3⅓ percent Federal electrical energy tax is long overdue and its repeal as proposed in the House bill is entirely justified. The tax unfairly discriminates against the customers of the private utility company, to whom the tax is ultimately passed on, as against the customers of the publicly owned electric plants who pay no tax. The tax is burdensome on the low-income groups and is levied on one of their necessities of life. Also, the tax is extraordinarily difficult and expensive to administer with its cumbersome distinction between residential and commercial customers who are taxed, and industrial customers who are exempt.

The House report on the bill amplifies the reasons for the repeal of the Federal electrical-energy tax, but is incomplete in one respect; the annual loss of revenue is estimated at $104 million. This estimate overlooks the fact that the tax is an allowable deduction in determining income and excess-profits taxes. Considering the effect of the proposed 52 percent corporation income tax alone, the net loss of revenue to the Government is reduced from $104 million to $50 million.

To meet the electrical needs of our Nation and its expanding defense program, our industry is currently engaged in its greatest expansion effort. Electric companies will spend over $7 billion in the next 3 years, and we estimate that $4 billion of this huge sum must be raised through the sale of our securities to the investing public. The sale of these securities will depend largely on our future earnings. If these earnings are seriously impaired, the prospects are poor——

Senator MARTIN. How will the other three billion be raised? $4 billion from the sale of securities. How will the other three be raised?

Mr. OAKES. The other three will come from retained earnings, namely, cash.

Senator MARTIN. Plowing back in?

Mr. OAKES. That is right. Plowing back in our earnings and reserves from depreciation.

Senator MARTIN. That was not clear.

Mr. OAKES. Oh, all right, sir.

If these earnings are seriously impaired, the prospects are poor, of raising the new capital we so urgently need to finance our construction program.

As a regulated industry, our earnings are small compared with our capital investment and are vulnerable to any sudden increase in expenses. Consequently, a tax increase will place us in a dilemma; either our earnings will be impaired and our construction program slowed down or halted or we must increase the price of electricity. When such a deficiency in net earnings is recovered by a rate increase the customers—if the tax rate is 50 percent—must pay twice the amount of the deficiency. This is a burden which customers of regulated businesses should not be asked to stand.

A retroactive tax increase such as that provided by the House bill would be especially adverse to the utility industry. Our small margin over expenses cannot readily absorb such an increase, and because so much of the year is already gone we cannot pass the tax on to our customers. As a matter of fact, the regulatory process through which electric rates to our customers are fixed is not adaptable to recover retroactive changes in taxes.

For these reasons, we are gravely concerned about the proposal to increase further the already high corporation income tax. The present and proposed high rates threaten the existence of the private enterprise system, and their continuance for even a short time may seriously damage the entire economy. They threaten particularly the ability of our industry to raise risk capital.

Senator MARTIN. Right there, you speak about the high taxes that you are paying. Just how much are they?

Mr. OAKES. Well, I brought some charts along which are an enlargement of the charts before you. I believe I can answer that question by referring to these charts, Senator.

Senator MARTIN. All right.

Mr. OAKES. Would you kindly turn over to chart 1. We show here a record covering a 15-year period of the taxes paid by electric companies. The red is the Federal tax and the yellow is the State tax.

In this 15-year period there are——

Senator CONNALLY. Is that yellow on top of the red, or just——

Mr. OAKES. It is the sum of the two which is the total tax paid.

For example, in 1950 it says $948 million. The red is $558 million in Federal taxes that were paid and State and local taxes amount to $390 million.

Senator CONNALLY. In addition?

Mr. OAKES. That is in addition.

Senator CONNALLY. Is that the total of the State and local taxes of all the 48 States?

Mr. OAKES. That is right. This is for the whole taxpaying industry.

Senator MARTIN. How much does that amount to in dollars?

Mr. OAKES. That is $948,000,000 in 1950; and on the basis of the pending tax bill, that total will increase to $1,162,000,000 most of it coming, of course, from Federal taxes.

Now, I would like to point out—you can see it right on the chart—that, on the basis of the 1951 pending tax bill, the Federal tax for 1951 is 60 percent greater than the highest war year, 1943, which is a measure of the taxes that would be paid by the utility industry, compared with war years. Thus you see the burden is really great.

Senator WILLIAMS. Is that increase on the basis of a percentage increase in the rates or just on the basis of the increase in dollars?

Mr. OAKES. The increase comes about from three sources: First, the increase in the rates themselves, and next, the increase in business we have had, generating larger taxable revenue; an the third—there is really a third—is the rate increases which have been made, particularly in the past year and a half, arising out of tax increases, and the increase in commodity prices, thus again making more corporate income to tax, so from those three sources you have that very large increase in Federal taxes.

Now, of course, particularly in our business, there is just no possibility of absorbing taxes; we have got to pass them on. So I would like to show you the impact on our customers by taxation.

If you take and measure these taxes in cents per average dollar paid by the customers for electricity, in 1949 the Federal taxes took 10.74 cents, State taxes 8.56 cents; and there was a total of 19.30 cents out of the dollar paid.

Going to 1951, the pending tax bill will increase Federal taxes to 14.47 cents, and the total will rise then to 23.23 cents out of a dollar.

Thus, we will be paying in this situation almost a quarter of our total income that we collect per dollar in taxes.

Senator MARTIN. That is your gross income?

Mr. OAKES. That is our gross; that is what the customer pays.

We have another comparison which distinguishes our industry from all other industries. Let us have this one first, gentlemen.

Here is an analysis which I think is quite pertinent. In 1949 the Federal income taxes were 8.53 cents; the electrical-energy tax was 2.02 cents—this is in cents per dollar paid by customers, and the miscellaneous small Federal taxes were 0.19 cents, making a total of 10.74 cents.

The removal of the 3⅓ percent electrical-energy tax, as provided in the House bill, means that 1.08 cents of that 2.02 cents goes back into our tax bill because the $104 million collected through the 3⅓ percent tax is a deduction for income-tax purposes. The increase, therefore in our taxable revenues because of that removal becomes taxable, and the income taxes on it would amount to 1.08 cents per customer, or 54 millions of dollars. This explains further the point I make a minute ago when I read that $104 million are the *gross* collections at the present time of the 8½ percent electrical-energy tax, and when eliminated actually 54 millions of it comes back into the Federal Treasury as income taxes.

Senator FREAR. Mr. Oakes, is that not assuming that you will leave the rate the same as it is now with that 1.08?

Mr. OAKES. That is assuming that the revenues are as they are now, sir, that is true.

Senator FREAR. If the 8½ percent electrical-energy tax is deducted from the consumer, you will not pay that difference; will you?

Mr. OAKES. Yes, we will because a little later I will arrive at a point here which will show that the increase in taxes has lowered our rate of return so great on 95 percent of the industry that all of us have to go to the commissions and ask for rate increases.

Now, the net reduction in expenses of 50 million, of course, will be considered by the commissions in allowing any rate increases, so, in effect, the consumers get the benefit of the reduction; it is really passed on to the consumer.

Senator BYRD. I understand that you have already started proceedings over the country to increase the rates.

Mr. OAKES. Many companies have already applied for rate increases. You see, the increase to 47 percent has affected so many of them that it was necessary, to get these rate increases. Some of them are just waiting to see what this final tax bill will be in order to institute rate increases, because they did not want to have one rate proceeding on top of another.

Senator BYRD. If you are successful in these applications, the final result will be that the consumer will pay the tax bill; is that correct?

Mr. OAKES. The consumer pays the tax bill in every case, Senator; that is true.

Senator BYRD. The increased taxes will be passed on to the consumer.

Mr. OAKES. By doing it through the Federal income-tax proceeding, as we will show in our presentation here, when there is a deficiency in net earnings below an allowable rate of return, we have to go to a rate process to restore it. We must impose $2 in rate increases for every dollar of deficiency that comes about because of increased taxes, and that calculation I will be glad to show you.

Now, that is what I meant when I said awhile ago that such a burden on our customers is an unfair burden.

Senator FREAR. Mr. Chairman, did I understand the witness to say that for every dollar of increase in taxes, the consumer would have to pay $2?

Mr. OAKES. That is correct.

Senator FREAR. What do you mean by that?

Mr. OAKES. I will be glad to explain that, sir.

Will you turn to those charts, gentlemen? The explanation is—I have a chart here which is simplified, and the explanation can be made in this way:

The 38 percent level of taxes obtained in 1939. Take a dollar of revenue—a hundred cents—as shown by that left-hand stack. The tax deductions from revenue which, of course, means our expenses, our State and local taxes, depreciation, and so forth, are 75 cents. We have left taxable income. Then we compute the income tax at the 38-percent level, and we would find that we have a 9½-cent amount of that dollar of gross revenue paid as Federal income taxes, leaving a net income of 15.50 cents which pays the rent on capital and the amount that we retain as earnings. That is the amount we need to insure a going business.

Now, suppose the income tax is increased to 52 percent. We still have the same deductions, 75 cents, and then if we make a calculation on the remaining net taxable income at 52 percent, we will find that we have 13 cents out of that dollar required for income tax, an apparent increase from the 9½ cents of 36.8 percent, and our net income reduces to 12 cents as compared with a required income of 15.5 cents.

We, therefore, must go to the regulatory bodies, and ask for an increase back to the 15½ cents; to restore 3½ cents, in other words.

Now, what is required in the way of an increase in gross to do that? We need 15½ cents. If the rate is at 52 percent, we divide the 15½ cents by 1 minus 52, which amounts to 32.29, which is the net taxable income required to pay Federal income taxes at 52 percent and leave the required net income of 15½ cents.

Therefore, the Federal income taxes required are 16.79 cents, the deductions, of course, being the same as they were in the other cases, so the increase in revenues from our customers is 7.29 cents, not the 3½ cents that would be apparent by merely applying the rate of 52 percent to our present taxable income and that increase of 7.29 cents goes to the Federal Government. Not a cent of it is retained by the companies.

Senator BYRD. You mean by that, if you had $100,000 increase in taxes, that then you would have to obtain $200,000?

Mr. OAKES. Yes, sir.

At the 52 percent rate that is exactly what would happen.

Senator BYRD. You have no increased costs? Why should you ask for $200,000?

Mr. OAKES. Because, let us go at it in a little different way—if we had an increase of $100 that is necessary to pay, say, at a 50-percent rate——

Senator BYRD. Leave the rate out. Let us deal in dollars. Leave out all percentages, and let us assume you are going to be increased $100,000 in taxes, and you are going to ask for a $200,000 increase in rates.

Mr. OAKES. In other words, that our net revenues remain the same. We would have to ask for $200,000 in a rate increase.

Senator BYRD. How is that?

Mr. OAKES. Let us go at it this way. $100,000 is the apparent increase. If we increase our revenues by that amount, to attempt to restore that $100,000 of tax increase, immediately our taxable income increases by $100,000 and half of that must be paid over as taxes above what is alread paid, so $50,000 of that would go to the Federal Government and $50,000 would be retained by the company, to bring its——

Senator BYRD. You are getting off the premise. We are assuming you are going to pay $100,000 additional taxes.

Mr. OAKES. Yes, sir.

Senator BYRD. Then you say you are going to the rate commissions and ask for $200,000 increase in rates.

Mr. OAKES. In order to pay the $100,000 increase, and in order to pay another $100,000——

Senator BYRD. But you are going on a percentage basis. I am speaking not of percentage, but a flat increase of $100,000.

Mr. OAKES. That is true.

Senator BYRD. Why do you need $200,000 to pay $100,000?

Mr. OAKES. All right. I will attempt to explain it this way. As soon as we increase the taxes the $100,000 increase reduces our net income remaining by $100,000. That has to be restored. When we restore it, suppose we restore it by adding on $100,000 in gross.

When we do that we also increase our taxable income by $100,000 and half of that goes to the Government so we therefore can only retain half of it.

We have half of the goal obtained.

In order to get the whole $100,000 restored in net, we have to again ask for another $100,000, and half of that goes to the Government, and half is retained.

Senator BYRD. Of the $200,000 you take in, you pay half in taxes.

Mr. OAKES. That is right.

Senator MARTIN. I see it.

Mr. OAKES. You have to do it twice because the Government always takes a half every time you raise it.

Senator MARTIN. I could not get it before.

Senator HOEY. It is just the same thing. I was going to say that when you get $100,000 additional, you increase the taxes, so it takes another $100,000 to meet the taxes that are involved.

Mr. OAKES. That is right.

Senator BYRD. That is right.

Mr. OAKES. As I said, the savings of the American people are the source of creative capital.

We are gravely concerned over the adverse effect of increased personal income taxes on the savings of individuals.

We offer evidence that higher Federal income tax rates, both personal and corporate, will further dry up this source of equity capital.

As a source of additional revenue, we urge that you apply the corporate income tax to the presently exempt publicly owned power projects. In 1951 under the pending tax bill we estimate that additional tax revenues of $107 million can be so obtained, a source not now tapped at all.

In time of national emergency, it is improvident to overlook this expanding source of revenue. Publicly owned projects have grown prodigiously during the past 15 years. And there is now under construction, or proposed, enough capacity to make the publicly owned plants comparable in size and output with the present taxpaying utilities. Some of the growth has been at the expense of private utilities through outright transfer of ownership or the competitive invasion of the private market. During the last 15 years, 47 electric companies have been taken over in their entirety and 23 have lost large segments of their property to public ownership. Public power should be a source of substantial tax revenue to the Federal Government. If it continues to grow at the expense of taxpaying utilities, the tax revenue now obtained from our industry will gradually disappear.

In addition, the tax exemption now enjoyed by public power is rank discrimination against the customer of the private utility company.

Under the regulatory processes to which private utilities are subject, it is the customer who pays the tax levied on the utility. For the year 1950, taxpaying electric utilities paid $558 million in Federal taxes—that is the point I just made—and under the pending House bill will pay approximately $724 million in 1951. These taxes amounted to 12½ cents out of every dollar collected from our customers in 1950, and will total 14½ cents on the basis of the pending bill.

Thus, a substantial part of the amounts charged our customers goes for Federal taxes. By contrast, the publicly owned electric projects pay no Federal tax. In effect, their customers are relieved of a substantial tax burden, while the customers of the privately owned utilities bear a heavy load. The time to end this discrimination is now.

In conclusion, we—

1. Ask you to confirm the action of the House in eliminating the inequitable and burdensome 8⅓-percent electrical energy tax.

2. Suggest that small investors be encouraged to save and invest in American enterprise by allowing a small exemption for dividends received.

3. Request that any changes made in the tax laws not be made retroactive, particularly for our industry.

4. Ask you to put an end to the existing unfair discrimination against the taxpaying electric light and power companies by removing the tax exemption now enjoyed by public bodies engaged in the power business.

5. Ask that the Congress reduce spending for nondefense items and limit corporate tax rates to present levels.

Senator HOEY. What portion of the increase has there been in public power in recent years in the United States; that is, tax-free? Of course, all public power is.

Mr. OAKES. Yes; that is correct. We have a couple of charts on that which I think will explain the point.

In 1930 the percentage of the total energy generated in the Nation by public bodies was 5.5 percent of the total. In 1950 it had grown to 18.9 percent.

This increase is almost 2½ times in the 20 years. Now, if you turn to the next one——

Senator HOEY. Of course, all of that power is tax-free.

Mr. OAKES. That is all tax-free; absolutely.

Senator MARTIN. Might I ask a question there? If that publicly owned power was taxed at the same rate as the privately owned electric organizations, how much tax would that be for the Federal Government? Have you had a calculation made of that?

Mr. OAKES. Yes, sir.

If the Federal corporate taxes under the House bill were applied to the earning estimates of public-power enterprises, the Government would collect $107 million and the collections would be divided as follows: Municipalities, 60½ millions; Federal authorities, 35½ millions; and non-Federal authorities, 11 millions. The impact, Senator, is most striking.

Turn to the next chart, please. This $107 million—this is corporate income taxes we are talking about—is more than the corporate income tax which is collected in 10 States all added together. There are the States and there are the amounts.

Senator WILLIAMS. That $107 million is, in effect, a subsidy for the companies in that area.

Mr. OAKES. What is that, sir?

Senator WILLIAMS. I say, it is a subsidy in effect for the industries in that area.

Mr. OAKES. Certainly, in part, to the extent that it would come from industry, that is true; and the rest of it is a subsidy which the general residential and commercial customers all over the Nation are paying, by paying the taxes that these customers in these areas are relieved of.

Now, also that $107 million, by comparison, is more than the corporate income taxes collected in each of 28 States in this Nation. So, you see, it is really a substantial amount.

Senator MARTIN. Mr. Chairman, I know our time is going, but I was not just quite clear on a statement the witness made.

You made mention of the repeal of the 3⅓ electrical-energy tax—how that would increase the Federal tax. I am not just clear on that.

Mr. OAKES. Will you turn back to that chart, please, sir?

Senator MARTIN. Because if there is any way we can get more revenue, that is the interesting thing to us right now.

Mr. OAKES. The 3⅓-percent energy tax is about 2 cents out of the revenue dollar that we receive today. Federal taxes are almost 10.2 cents. This 3⅓-percent energy tax is a tax deduction for the purpose of computing the Federal income tax. Therefore, if we are relieved of the 3⅓-percent energy tax, our taxable net income for corporation tax purposes increases. Therefore, half of the amount of the 3⅓-percent energy tax that we pay now comes back to the Government through the corporate tax.

Senator BYRD. This 104 million is the total?

Mr. OAKES. Total gross received from the 3⅓-percent energy tax.

Senator BYRD. And is no longer a deduction as part of your expenses, and then you pay an income tax on that of 52 percent?

Mr. OAKES. That is correct.

Senator BYRD. So you pay more than half of it back?

Mr. OAKES. That is correct.

Senator BYRD. That is not allowed—that deduction is not allowed and is not made in this $104 million estimate?

Mr. OAKES. No; that is right.

Senator BYRD. Is there anything further, Mr. Oakes?

Mr. OAKES. Thank you very, very much, sir. I appreciate this opportunity to appear before you.

Senator CONNALLY. I want to ask one question.

Mr. OAKES. Yes, sir.

Senator CONNALLY. Is one of your chief difficulties the getting of additional capital? That is one of them; is it not?

Mr. OAKES. Yes, sir.

Senator CONNALLY. One of your difficulties is attracting investment into these companies?

Mr. OAKES. That is correct. That is a very, very——

Senator CONNALLY. What effect on that does the high tax have?

Mr. OAKES. We have a couple of charts on it which I think are——

Senator KERR. You can just make a statement.

Mr. OAKES. Well, I can make it from these charts quite easily.

This industry of ours is unique compared with all other industries. We have made a study of the capital required for expansion—new money—since the end of the war, and we find that 75 percent of all the new money that was obtained for industries in general came from retained earnings, and 25 percent was obtained by the sale of securities.

Now, the reverse of that is true for the electric power and light companies. Only 39 percent came from retained earnings. We did not earn enough to finance all our expansion from internal sources; and so 61 percent came from the sale of stocks and bonds.

Therefore, any change in our net earnings position is immediately reflected in our ability to sell our securities.

If you will turn to the next chart you will see that the margins left over to us after paying all expenses, including taxes, have been going down very markedly since 1939.

In 1939 we had left over for, say, wages of capital—that means interest and dividends and that sort of thing—and the amount retained in our business, about 35 percent of the dollar received from the customer. It had gone down to 21½ percent by 1950 and on the basis of this pending tax bill will again reduce to 20 percent.

Now, those margins are reflected immediately in the prices of securities in the market, and therefore any change in taxes is immediately reflected in net, and in our ability, of course, to finance.

If you turn to the next chart we will show you what the effect has been on the companies.

Now, this margin that I just talked about, if you divide what we have left after all expenses into the plant account of the companies, you have a percentage which is a measure of the earnings position of the companies.

I have taken the entire industry and broken it up into four parts. I have adjusted the data to reflect the pending tax bill. By assembling the plant account of those companies which would earn between 5 and 6 percent, that is one-third of the industry.

Those companies that would earn between 4 and 5 percent are 26 percent of the industry; and those companies which would earn on plant account less than 4 percent are 37 percent of the industry, so by just looking at those figures—these are not rates of return allowed by regulatory bodies, but they are very close to that; they are a real measure of the situation.

Now a survey of those figures indicates that our ability to sell our securities would be impaired by the pending bill. That is why I said a bit ago that any changes in taxes today, any further increase, will immediately require all of us to go to the regulatory bodies, so that we can at least approximate the earnings rate of return that we now have—ask them to restore them.

Thank you very much.

Senator FREAR. Well, you can go to a regulatory body and get your additional increase in rate for those taxes; can you not?

Mr. OAKES. Yes; generally, I think they would grant it. They are under obligation to grant it.

But, as I said a bit ago, when we go to them because of increase in Federal income taxation, we have to ask the customer for twice as much——

Senator FREAR. Yes.

Mr. OAKES. And we think that is inflation; the cycle that goes on and on.

Senator FREAR. I think I understood that.

Senator MILLIKIN. Mr. Chairman, I did not hear all of this testimony.

What is your point? What do you want?

Mr. OAKES. We would like first, Senator, to have the Senate go along with the House and eliminate the inequitable and burdensome 3⅓ percent electrical energy tax.

We would like to suggest that small investors—and this applies directly to the point I am making just now——

Senator CONNALLY. You point to me as indicating that I am a very small investor.

Mr. OAKES. I did not mean to point to you, Senator, at all. [Laughter.]

Senator CONNALLY. You said a small investor, and pointed at me.

Mr. OAKES. I did it by way of emphasis, sir.

We suggest that small investors be encouraged to save and invest in American enterprise by allowing a small exemption for dividends received—and by "small," I mean very small.

Senator CONNALLY. Mighty near nothing?

Mr. OAKES. Yes. $200 would encourage—would bring in thousands of new investors to which we could go to sell our securities.

We request that any changes made in the tax laws not be made retroactive—that is another of the requests that we made, Senator—and we also request that you put an end to the existing unfair discrimination against the taxpaying electric light and power companies by removing the tax exemption now enjoyed by public bodies engaged in the power business; and the last one of our suggestions was we reduce spending for nonessential or nondefense items and limit corporate tax rates to present levels, if it can possibly be done.

Senator MILLIKIN. Thank you very much.

Senator BYRD. Thank you, sir.

Senator CONNALLY. Do you represent all of the electric privately owned companies?

Mr. OAKES. Yes, sir.

Senator CONNALLY. Your association covers them all?

Mr. OAKES. Yes, sir.

Senator CONNALLY. The Edison Electric Institute——

Mr. OAKES. Yes, sir.

Senator CONNALLY. That is a trade institute, I suppose?

Mr. OAKES. Yes, sir; and covers practically every public utility in the country. There are very few that are not members.

Senator CONNALLY. So, you are speaking for all of them.

Mr. OAKES. I am speaking for all of them.

Senator CONNALLY. And the difficulties that you pointed out as to financing and all of that apply to all of them?

Mr. OAKES. Yes, sir; it applies to all of them. Let me remark: The expansion program that we have had since the war period, if carried on through the year 1953, as we now plan it, will mean that we have expanded by $15 billion, and our plant account at the end of 1953, in my opinion, will pass that which the railroads of the country now have.

In other words, our industry in 1953 will be a bigger industry than it is now so far as plant account goes; so, we are really a large industry.

Senator BYRD. What is the amount you expect to increase it by?

Mr. OAKES. We expect in the next 3 years that 7 billions in new money will be required, and we must raise at least 4 billions of that. The other three will come from internal sources.

Senator BYRD. Thank you very much, Mr. Oakes.

Mr. OAKES. Thank you very, very much.

Senator CONNALLY. I am glad to have heard you, Mr. Oakes. We are all interested in these problems.

(The prepared text and charts of Mr. Oakes and a statement of the American Public Power Association follow:)

STATEMENT OF CHARLES E. OAKES, PRESIDENT, PENNSYLVANIA POWER & LIGHT CO. AND CHAIRMAN OF SPECIAL TAX POLICY COMMITTEE OF EDISON ELECTRIC INSTITUTE

My name is Charles E. Oakes. I live at Allentown, Pa. I am president of Pennsylvania Power & Light Co., which serves a portion of eastern Pennsylvania and which is wholly and directly owned by the general public.

I appear before this committee as chairman of the special tax policy committee of the Edison Electric Institute, to present its views with respect to the effect of the pending tax bill upon the electric-light and power companies of this country. The Edison Electric Institute is a trade association representing 82 percent of the taxpaying electric-utility industry of our Nation. This industry has over $19,500,000,000 of plant and property, receives gross revenues of over $5,000,000,000 per year, and will pay well over a billion dollars of taxes in 1951.

The electric companies appreciate the difficult task confronting this committee. We are concerned about the future of our country with respect to both national defense and inflation. We believe, like businessmen generally, that we should pay for national defense as we go along.

To conserve the time of this committee, I have prepared some charts to illustrate the impact of taxation on electric-power and light companies, and the suggestions we are making at this time. The latest available statistics have been used throughout.

In my opinion, it is essential to consider taxes not only from the viewpoint of their impact on our industry and its customers but also in relation to their effect on national welfare either through higher rates, impaired service, or lack of sufficient electric power.

Chart I shows the 15-year record of dollars paid by the electric-light and power companies for taxes. In the period shown they have aggregated the considerable sum of $9,500,000,000. This amount of money is greater than the total Federal taxes collected in 1941—Pearl Harbor year.

The 1951 Federal taxes shown are estimated on the basis of the pending tax bill as it passed the House, and are over 60 percent greater than the highest annual Federal tax payments ever made by the industry during World War II.

Like all industry, the electric-light and power companies include taxes in the rates charged for their product, for they have no other source of funds. Therefore, taxes imposed directly on the electric companies become taxes on the consumers of electricity. So, I am speaking for our customers as well as for the companies.

For this reason, chart II is not in dollars paid by the companies. Instead, it shows the cents of the average dollar paid by the customers of the companies, which must be set aside for taxes. It shows the actual taxes so paid in 1949, when the Federal corporate-tax rate was 38 percent; in 1950, when the effective corporate rate was 42 percent, and as estimated for 1951 under the provisions of the pending bill. This is the most effective way of showing how heavy a tax burden is placed on our customers. On the average, nearly one-quarter of the amount the customers of the electric companies will pay for electricity in 1951 will go for taxes.

Chart III shows only the Federal taxes for the last 8 years, broken down as to kind. The 1951 tax bill as passed by the House eliminated the 3⅓-percent electrical energy tax. To illustrate the relative change in the situation, I have shown 1951 without the 3⅓-percent tax. Actually, under the provisions of the pending bill, it would not be removed until the new tax bill is passed, and thus there would be an "overlap" for a portion of the year.

The 3⅓ percent electrical-energy tax was deductible in its entirety, just like operating expenses, before determining the income subject to Federal income taxes. Its removal will, therefore, increase our Federal income taxes because it will increase the income subject to such taxes.

The Report of the Committee on Ways and Means of the House of Representatives, page 50, stated:

"It is estimated that in a full year of operation the repeal of this 3⅓ percent electrical-energy tax will reduce revenues by $104 million annually."

This $104 million is the gross amount of the reduction for the entire year. However, the Federal income tax on it will be $54 million, leaving $50 million as the net reduction in tax revenues of the Federal Government by reason of the repeal of the 3⅓-percent electrical-energy tax.

The 3⅓-percent electrical-energy tax applied only to residential and commercial customers and thus discriminated in large measure against low-income groups. It also discriminated against the customers of the electric-light and power companies, as public bodies in the power business did not pay the tax. The administration of this tax was costly to both the electric companies and the Treasury of the United States. It involved the repeated examination of millions of accounts, and periodic review of the status of many of them. Its elimination by the House was wise.

Proportionately, the electric companies pay a much heavier burden of Federal income taxes than the average American business. This is illustrated by chart IV. The proportions are for the fiscal year 1948, the latest for which the information is available. Although the electric companies had less than 1 percent of the total compiled receipts of corporations filing income-tax returns, they paid over 2½ percent of the total corporation income taxes.

Chart V is concerned only with Federal income taxes. It contrasts the electric companies with representative companies in the various industries shown in terms of the proportion of the average dollar paid by customers which must be set aside for taxes.

A much larger proportion of the electric customers' dollar must be set aside for taxes than in the other cases. It is evident that the amount needed as a price increase to the customer to cover any tax increase is far less for such nonutility companies than it is for the electric-utility companies.

It is obvious that Federal income taxes bear much more heavily upon the customers of the electric companies than upon those of most other businesses.

Chart VI illustrates another of the other important differences between businesses. It shows the large amount of investment required by the electric companies to obtain $1 of annual revenue, as compared with the same businesses shown on the preceding chart. The electric companies' average requirement of $4.09 for each dollar of annual revenue is 45 times greater than the 9-cent requirement of the retail grocery chain. Federal income taxes on corporations are levied on the wages of risk capital and preferred stock. As a result, when large investments are required to produce annual revenue, as is the case in respect to the electric light and power companies, Federal income taxes are a heavy burden.

There is a great difference between the electric companies and nonutility businesses in their ability to absorb a tax increase, and in the ease with which it can be passed on to the customer.

The electric-utility companies are regulated businesses, with their rates fixed by law. To obtain rate increases requires regulatory commission action, and this takes time. This lag in itself is serious; but, if it is further compounded by the enactment of a retroactive tax bill, the resulting maladjustment in our industry could well be critical.

While part of our economy is now subject to wartime regulation, the greater part is not; and, in any event, changes in the price charged for goods by an ordinary business is a much more simple process than it is for a regulated utility.

The business of the electric-light and power companies is expanding rapidly. They must finance and build, for what they supply is a national necessity.

Immediately upon the close of World War II, the electric companies embarked upon a vast postwar expansion program to meet the power needs of our Nation. This program will cost $15 billion through through 1953, and there is no end in sight to the increase in the power requirements of the United States beyond that arbitrary date.

The electric companies will spend over $7 billion on new construction in the next 3 years. Even with this vast sum, the companies will barely keep ahead of the growing demands for national defense. An adequate supply of power is essential to the safety and welfare of the Nation.

Money for expansion comes from two sources: internal and external. Many businesses can secure most or all the capital they need from the revenues of the enterprises. Chart VII illustrates what took place during the postwar period. It shows that industry as a whole obtained three-quarters of its new capital requirements from internal sources, whereas the electric companies could obtain only 39 percent in this way, and had to secure the other 61 percent in the competitive money markets of this country.

In 1950, the electric-light and power companies did over 27 percent of all the new money corporate financing in this country, although on a receipts basis they are less than 1 percent of the total of all corporations in this country.

In order to secure new money at favorable rates, the companies must demonstrate that their present earnings and future prospects are good. If earnings show evidence of deteriorating, the cost of new money will go up, and, in the end, will cease to be available at any reasonable price. Such a result would be disastrous to the welfare of our country.

The Nation is experiencing a serious inflation. Its extent is illustrated by chart VIII, which shows the "all commodity" index by months from 1940 to date. The index shows that prices of "all commodities" have more than doubled since 1940. In common with everyone else, the electric companies have to pay increased commodity prices and wages.

The effect of this inflation and increased taxes upon the electric-light and power companies is shown by chart IX.

The margin remaining after expenses is the amount available for rent of capital and for the earnings which must be retained if the businesses are to remain on a sound, conservative basis and be able to attract the new money needed by an expanding industry.

The figures are average for the entire business-managed electric utility industry. Of course, individual companies vary from this mean.

Inflation and high taxes had crowded in on this margin to a serious extent by 1950. The pending tax bill would encroach still further upon it. To offset the loss, wholesale rate increases will be necessary if disaster is to be avoided.

Chart X is based on 1950 figures for the individual electric-light and power companies, adjusted to reflect the effect of the pending tax bill. It shows the ratios of the earnings of the companies after depreciation and taxes, to plant accounts. Less than 5 percent of the industry had margins greater than 6 percent. Nearly two-thirds had margins less than 5 percent.

I want to make it very plain that the figures I have shown above are not the returns on a "rate base" which would be used in fixing rates. These are set by regulatory commissions after hearings and consideration of all factors involved. The figures on the chart do indicate however, that under the pending tax bill most electric companies would have a margin below the levels generally allowed by regulatory bodies.

Should the pending bill become law electric companies all over the Nation would be forced to apply to their regulatory bodies for increased rates. Delays would be unavoidable. Earnings would be impaired, thus making financing difficult or impossible, and slowing down or halting essential portions of the construction program. This would be a national disaster.

Earnings must be maintained at levels high enough to secure new risk money at reasonable rates of hire. To raise rates to do this will put an extra burden upon our customers, which I believe to be unfair.

I would like to explain what I mean by the simplified example shown on chart XI, as the point is hard to see at first glance.

In 1949 the corporate-income tax rate was 38 percent. The pending tax bill provides a 52-percent rate. This represents an apparent 36.8-percent increase in 2 years. But it is not the true increase if the net earnings are to remain at the 1949 level, as they must in most instances if the electric companies are to obtain the needed new money at reasonable prices. The true increase in taxes will be 76.7 percent.

The first stack shows the situation in 1949, when the corporate income tax rate was 38 percent. The top section shows the deductions made for income-tax purposes in order to get a base for calculating the Federal income tax.

The next section shows the Federal income tax at 38 percent. The bottom section shows the resulting net income after taxes, which is at the minimum level consistent with the needs of the company for raising new capital.

Now move to the center stack. This shows what happens when the Federal income tax rate is increased to 52 percent. On the face of the figures, this would represent an increase of 30.8 percent in taxes. Such an increase would take an additional 3.5 cents from each dollar of revenue, and would cut down the net income by a corresponding amount.

Now, at first glance it would seem that in order to meet this increase in taxes by increasing rates, all that would be necessary would be to charge the customer an additional 3.5 cents on each dollar paid.

The Federal income tax, however, does not work that way. The stack on the right shows what would really happen if the net income of 15.5 cents is to remain intact. In order to collect a Federal income tax of 52 percent, and still have 15.5 cents of net income remaining, a net taxable income of 32.29 cents would be required, and the income tax would be 16.79 cents. Thus the increase in taxes over the 38 percent would be 7.29 cents, which is a boost of 76.7 percent over the 1949 rate level, instead of the 30.8 percent which was indicated by the increase in the income-tax rate.

Thus the customers would have to pay 7.29 cents more to take care of a Federal income tax increase that on its face amounted to only 3.5 cents. Said another way, the customers must pay over twice the apparent tax increase.

The electric companies would not get a cent of this added amount. It would all go to the tax-collecting agencies.

We believe that corporate-income taxes and personal-income taxes are higher than is good for industry and the general public. Specifically, we believe that the 47-percent rate now in effect is higher than industry can long endure without serious adverse results, and that the proposed increase would be disastrous to our economy. The effect which I have just been illustrating would be extremely inflationary, and the weight of these taxes is so great as to destroy by indirection our American economic system.

We are gravely concerned by the retroactive provisions of the pending tax bill. We are a regulated industry, with rates established on the situation which now exists. Regulatory bodies do not grant retroactive rate increases. So, it will be impossible for the companies to recover retroactive taxes. Dividends have been paid, and financing has been undertaken on the basis of existing tax rates. We ask you to make any changes in tax rates which you may find to be necessary effective after the passage of the tax bill.

I appreciate that suggestions are in order as to the course which might be followed to avoid the adverse effects which I have been describing.

The first suggestion would be, of course, to reduce the need for additional taxes by eliminating nonessential Government expenditures. A businessman is apt to judge such matters by what he himself knows to be true in his line of endeavor. The Federal budget for the fiscal year 1952 contained requests for appropriations for Federal bureaus engaged in the power business totaling well over 1¼ billion dollars. Part was to be used to initiate new power projects that could not be ready for years to come. Part was to complete projects that have just been started, and which could not possibly be ready for several years. Part was for duplicating existing transmission lines. Part was for power facilities which the electric companies, if given a chance, would build.

The Congress made extensive cuts in such appropriations for the fiscal year 1952, but a great deal more money could be removed without any adverse effects on our economy. On the contrary, such a step would improve it.

The new capital required by American business comes from the savings of its citizens. The increases in corporate and personal-income tax rates which have taken place in recent years are "drying up" the source of creative capital. Let me show you what is taking place.

Chart XII reproduces an advertisement which appeared recently in a New York newspaper. It promotes the sale of tax-free securities by emphasizing the tax discrimination which exists against the electric-light and power companies. You will note that it "plays up" the pending tax bill, implying that the proposed increase in personal-income tax rates should impel the investor to buy the tax-free bonds.

Chart XIII shows that the percent of income of individuals in every income bracket, attributable to dividends, had fallen greatly in the period 1935–47, and the evidence at hand shows that it is still going down.

The pending bill, should it become law, will still further restrict the creation of new capital by diverting current savings to pay personal taxes. Additional increases which may be necessary would again reduce the money available for investment in corporate securities.

The man with large income evidently has been getting out of investments in corporate equities. The only reason for such a person to own stock is for pure speculation where gains are subject to the capital-gains tax. He is not interested in the income from dividends, for such income is almost entirely taxed away.

Chart XIV illustrates what happens to the investor in various income brackets. I have started with an earning of $5 per share before Federal income taxes. My chart is based on a dividend payment of 75 percent of earnings available after payment of Federal income taxes. Let me start with the little fellow first—the one with $3,000 adjusted gross income. In 1949 the company, out of the $5, would have paid $1.90 in Federal income taxes. This would have left $3.10 for the investors. The company would retain a quarter of this or 77 cents, leaving $2.33 as income to the investor. He would have paid 39 cents in personal income taxes at his marginal rate (16.6 percent), leaving him with $1.94 out of the $5 earned for him by the company.

Under the pending tax bill, this little fellow's net share would be cut to $1.89.

Now look at the rear stacks—the big fellow. In 1949, his net share out of the $5 would have been only 42 cents. Under the pending tax bill, this share, small as it was, would shrink to only 10 cents.

It is no wonder that all investors are losing interest in common stock.

An analysis of the stock ownership of a number of large American corporations shows that more than 80 percent of their stockholders own less than 100 shares each. These investors of moderate means are becoming more and more aware of how their savings are being reduced through extortionate double taxation. In the face of mounting taxes, it is astonishing with what tenacity individual investors have sought to retain their ownership in Amercan enterprise.

If the new tax law could be so drafted as to encourage savings by the citizens of moderate means and their investment in American industry, a great step forward would have been taken. A way to accomplish this would be to give the little fellow a specified exemption for dividends received.

Now, I want to talk about tax discrimination.

The electric utility industry in America is in three parts. The larger portion consists of the electric light and power companies. They pay a heavy and full burden of Federal, State, and local taxes. The next portion in size, and growing rapidly in extent, consists of various public bodies—Federal, State, and municipal. This portion pays very little or no Federal taxes, and an insignificant amount in lieu of State and local taxes. The third, and smallest portion, consists of the rural electric cooperatives.

Freedom from Federal taxation is only one of the many special privileges enjoyed by electric power enterprises operated by political bodies, but it is the most unjust.

Tax discrimination not only hurts; it threatens the very existence of the electric companies.

President Truman, in his tax message of January 23, 1950, expressed the gravity of such a situation better than I can, when he said:

"A tax concession to a favored few is always unfair, but it becomes a gross injustice against the rest of the population when tax rates are high. The case for the elimination of these inequities would be strong even if there were no need for replacement revenue."

No Federal taxes are paid by Federal, State, and municipal power enterprises except excise taxes on purchased materials and services. The discrimination is almost complete in this field.

When the Federal tax exemption was first granted to public bodies engaged in the power business the taxes on the electric companies were so small in relation to revenues that the discrimination was negligible. But now it has become extremely serious, and the pending tax bill will make matters worse.

Due to these tax advantages, which during the last 15 years have steadily increased in extent and significance, 47 electric companies have been taken over in their entirety, 23 electric companies have lost large and important segments of their property, and a considerable number of others have lost minor segments to power enterprises owned and operated by public bodies. This trend is a serious matter to the electric companies.

Chart XV illustrates extent of the growth of public bodies in the power business by showing the amount of energy generated by enterprises that pay very little or no Federal taxes.

Serious as it is, what has taken place to date is insignificant in the light of what may be ahead. The map which is chart XVI shows the portion of the Federal electric generating plant program that we know about, including certain State projects which have been financed in whole or in part by the Federal Government. The map shows a total of 631 power projects in service, under construction and proposed, with a total ultimate installed capacity of over 56,300,000 kilowatts. We believe that the plants shown on this map will produce on the order of 250 billion kilowatt-hours a year of power free of Federal taxes. The total generation of the taxpaying utilities for 1950 was only slightly more than this figure.

I have shown you these charts, and quoted these figures, to show the great scope of the tax-free power business of the future if this favored segment of the power industry continues to enjoy this profitable special privilege.

I have in my hand a copy of the report of the legislative committee to investigate the power situation in South Carolina, both public and private, as it was printed in the Journal of the House of Representatives of the State of South Carolina, Tuesday, February 13, 1951. I quote from it as follows:

"* * * we conclude that the private power companies are carrying the vast tax load and that public power is all but exempt from all taxes. In the light of this, we feel that private companies are being discriminated against for most certainly public power with less than a half million for all taxes can sell power cheaper than private companies, when they are paying in the neighborhood of 18 million in taxes.

That is enough to give any citizen who has his State's welfare at heart pause for thought. For we do not want a welfare or socialistic state in South Carolina. * * * The private companies * * * carry a terrific tax load which constitutes unfair competition; it is not fair for our lawmakers to discriminate one against the other."

We appreciate that the Senate Finance Committee can deal only with Federal taxes, but the removal of this part of the discrimination against the electric light and power companies would go far toward correcting this unjust situation.

The time to end this tax discrimination is now. It is only human nature to object violently to losing some special privilege which gives to its owner a big advantage over his neighbor. If the public power empire is to grow in size and political strength, it will be increasingly difficult to right this wrong.

The extension of Federal taxes to power businesses conducted by public bodies would bring in badly needed tax revenues from a segment of our people which is not paying its full share of the cost of the Federal Government.

Chart XVII shows total estimated additional Federal tax revenues which could be obtained by taxing electric businesses owned and operated by public bodies in 1951 under the pending tax bill, to be about $107,000,000. Much of the revenue from municipalities would come from cities that are also beneficiaries of subsidized Federal power.

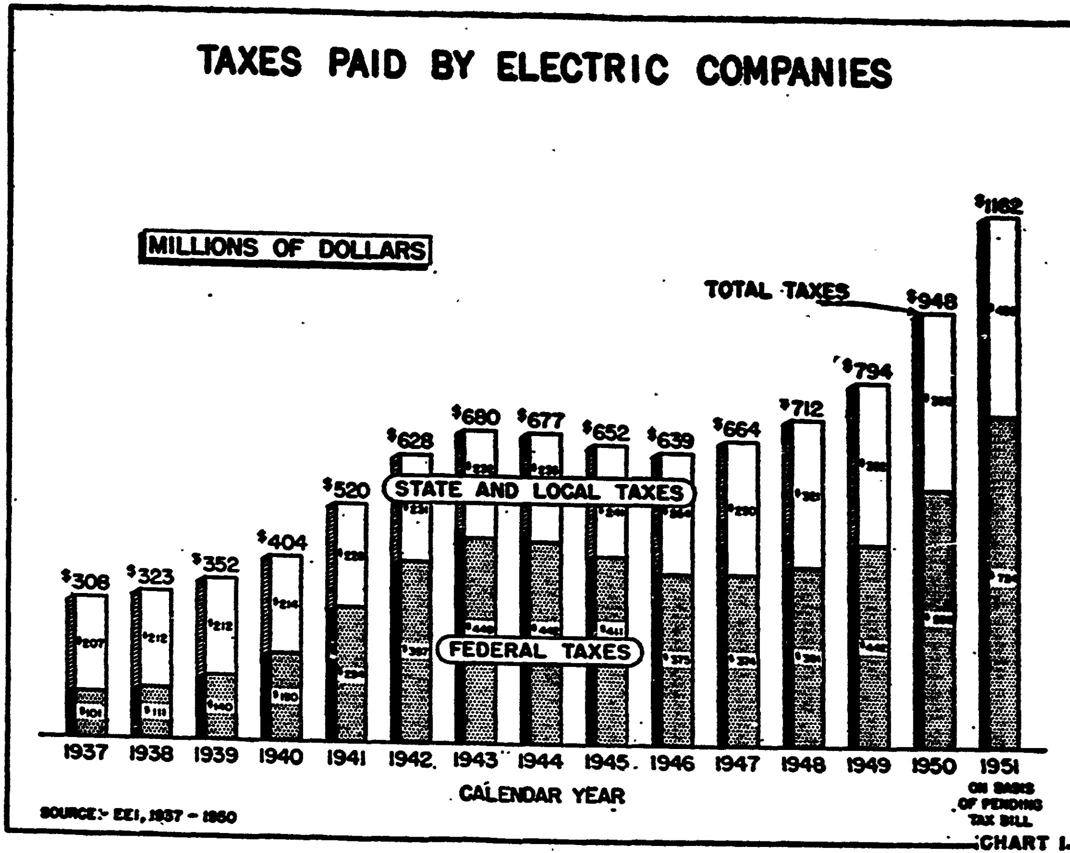
This amount of tax revenue is a considerable sum as is shown by chart XVIII. It is greater than the corporation income tax that was collected from any one of 28 States in the fiscal year 1950. It is greater than the total corporation income tax collected from 10 States in the same year.

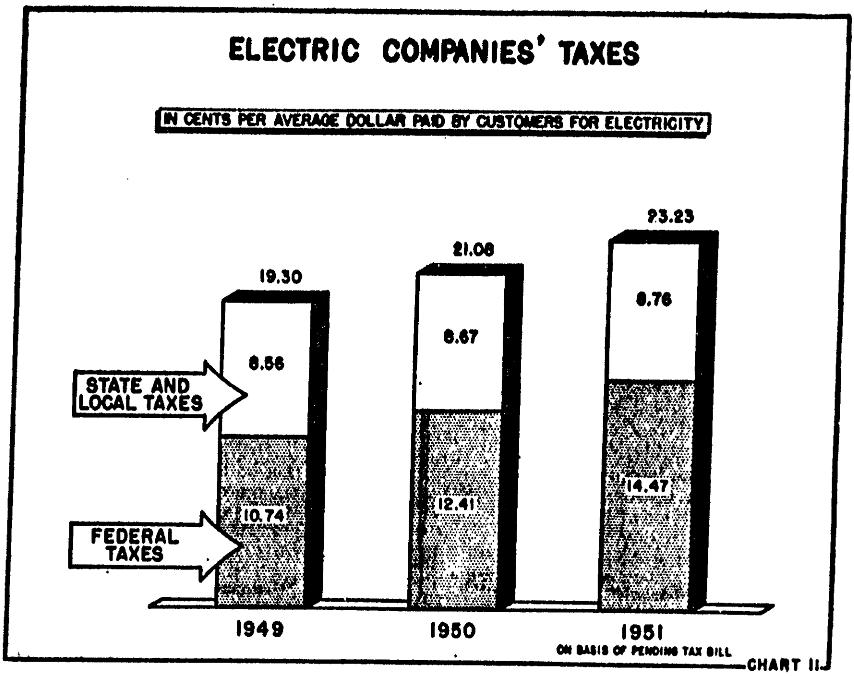
Chart XIX shows that over one-half of this tax revenue loss takes place in four States—California, Tennessee, Washington, and Nebraska. These same four States, however, paid only 10½ percent of the total personal and corporate income taxes paid in the United States.

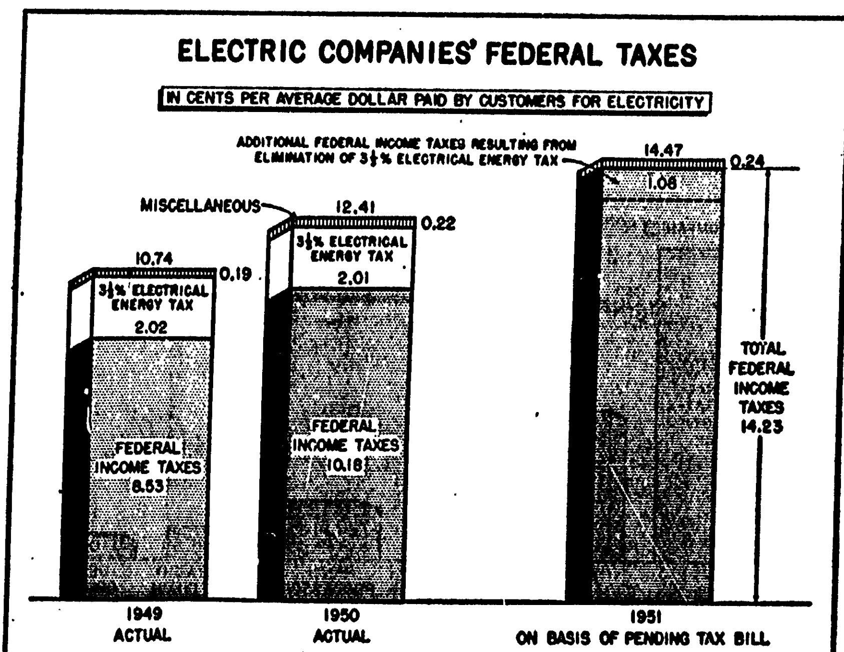
In conclusion, we—

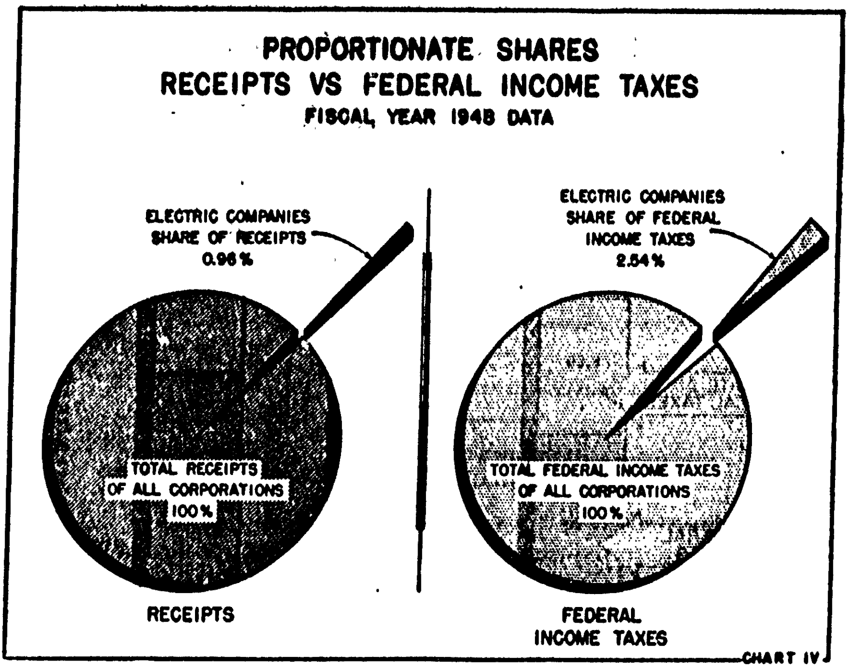
1. Ask you to confirm the action of the House in eliminating the inequitable and burdensome 3⅓-percent electrical energy tax.
2. Suggest that small investors be encouraged to save and invest in American enterprise by allowing a small exemption for dividends received.
3. Request that any changes made in the tax laws, not be made retroactive.
4. Ask you to put an end to the existing unfair discrimination against the taxpaying electric light and power companies by removing the tax exemption now enjoyed by public bodies engaged in the power business.
5. Ask that the Congress reduce spending for nondefense items and limit corporate tax rates to present levels.

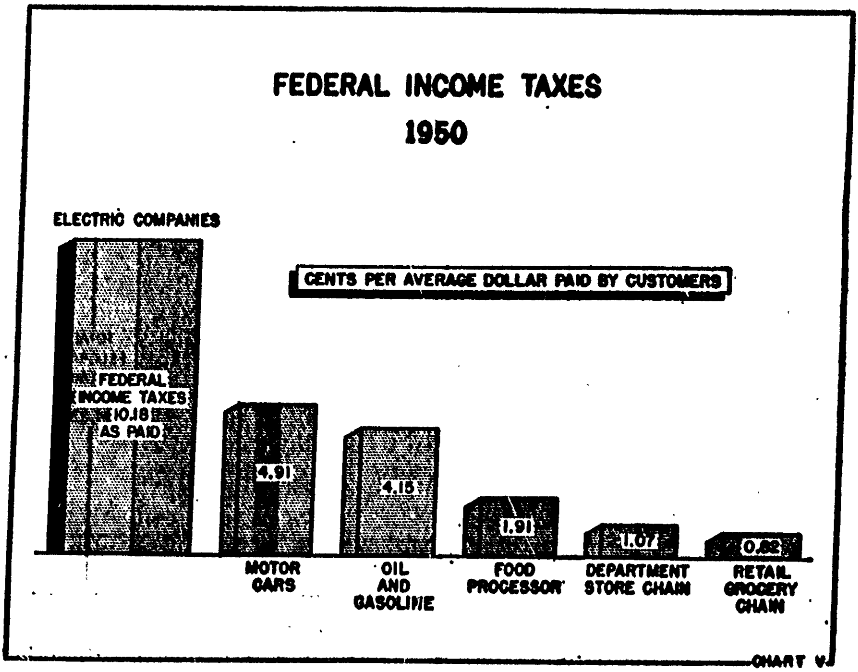
I thank you for your attention.

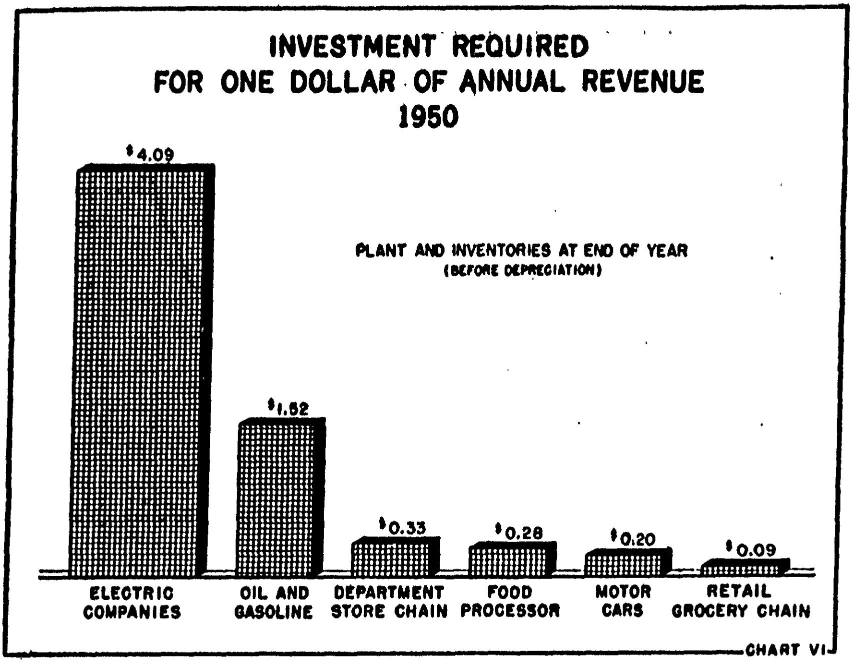

TAXES PAID BY ELECTRIC COMPANIES
MILLIONS OF DOLLARS
TOTAL TAXES
STATE AND LOCAL TAXES
FEDERAL TAXES
$308
$323
$352
$404
$520
$628
$680
$677
$652
$639
$664
$712
$794
$948
$1162
1937
1938
1939
1940
1941
1942
1943
1944
1945
1946
1947
1948
1949
1950
1951
ON BASIS OF PENDING TAX BILL
CALENDAR YEAR
SOURCE:- EEI, 1937 – 1950
CHART I

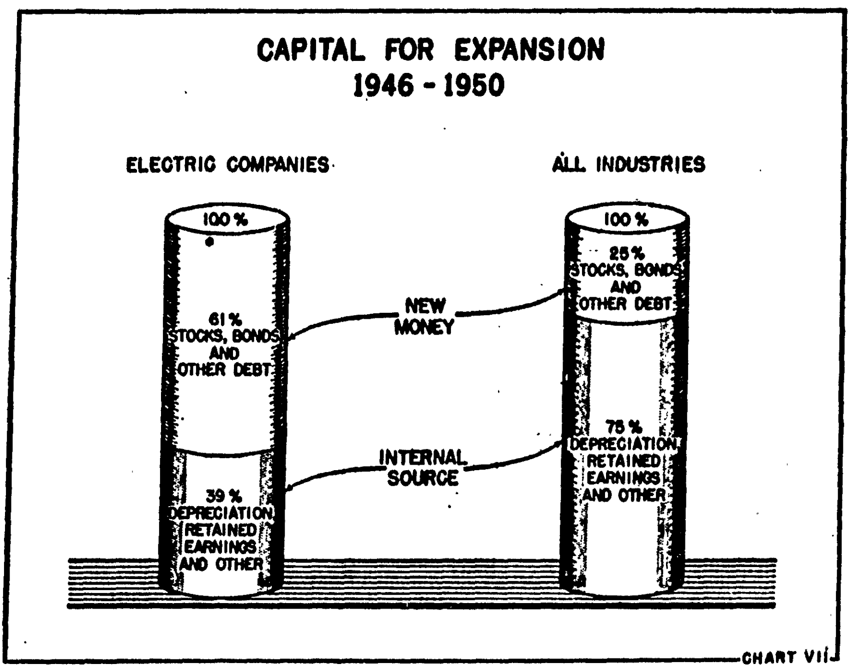

ELECTRIC COMPANIES' TAXES
IN CENTS PER AVERAGE DOLLAR PAID BY CUSTOMERS FOR ELECTRICITY
19.30
21.08
23.23
8.56
8.67
8.76
STATE AND LOCAL TAXES
FEDERAL TAXES
10.74
12.41
14.47
1949
1950
1951
ON BASIS OF PENDING TAX BILL
CHART II


ELECTRIC COMPANIES' FEDERAL TAXES
IN CENTS PER AVERAGE DOLLAR PAID BY CUSTOMERS FOR ELECTRICITY
ADDITIONAL FEDERAL INCOME TAXES RESULTING FROM ELIMINATION OF 3½% ELECTRICAL ENERGY TAX
MISCELLANEOUS
10.74
0.19
3½% ELECTRICAL ENERGY TAX
2.02
FEDERAL INCOME TAXES
8.53
12.41
0.22
3½% ELECTRICAL ENERGY TAX
2.01
FEDERAL INCOME TAXES
10.18
14.47
0.24
1.06
TOTAL FEDERAL INCOME TAXES
14.23
1949
ACTUAL
1950
ACTUAL
1951
ON BASIS OF PENDING TAX BILL
CHART III


PROPORTIONATE SHARES
RECEIPTS VS FEDERAL INCOME TAXES
FISCAL YEAR 1948 DATA
ELECTRIC COMPANIES SHARE OF RECEIPTS 0.96%
ELECTRIC COMPANIES SHARE OF FEDERAL INCOME TAXES 2.54%
TOTAL RECEIPTS OF ALL CORPORATIONS 100%
TOTAL FEDERAL INCOME TAXES OF ALL CORPORATIONS 100%
RECEIPTS
FEDERAL INCOME TAXES
CHART IV


FEDERAL INCOME TAXES
1950
ELECTRIC COMPANIES
CENTS PER AVERAGE DOLLAR PAID BY CUSTOMERS
FEDERAL INCOME TAXES 10.18 AS PAID
4.91
4.15
1.91
1.07
0.82
MOTOR CARS
OIL AND GASOLINE
FOOD PROCESSOR
DEPARTMENT STORE CHAIN
RETAIL GROCERY CHAIN
CHART V


INVESTMENT REQUIRED
FOR ONE DOLLAR OF ANNUAL REVENUE
1950
$4.09
$1.52
$0.33
$0.28
$0.20
$0.09
PLANT AND INVENTORIES AT END OF YEAR
(BEFORE DEPRECIATION)
ELECTRIC COMPANIES
OIL AND GASOLINE
DEPARTMENT STORE CHAIN
FOOD PROCESSOR
MOTOR CARS
RETAIL GROCERY CHAIN
CHART VI


CAPITAL FOR EXPANSION
1946 - 1950
ELECTRIC COMPANIES
ALL INDUSTRIES
100%
61% STOCKS, BONDS AND OTHER DEBT
39% DEPRECIATION, RETAINED EARNINGS AND OTHER
100%
25% STOCKS, BONDS AND OTHER DEBT
75% DEPRECIATION, RETAINED EARNINGS AND OTHER
NEW MONEY
INTERNAL SOURCE
CHART VII

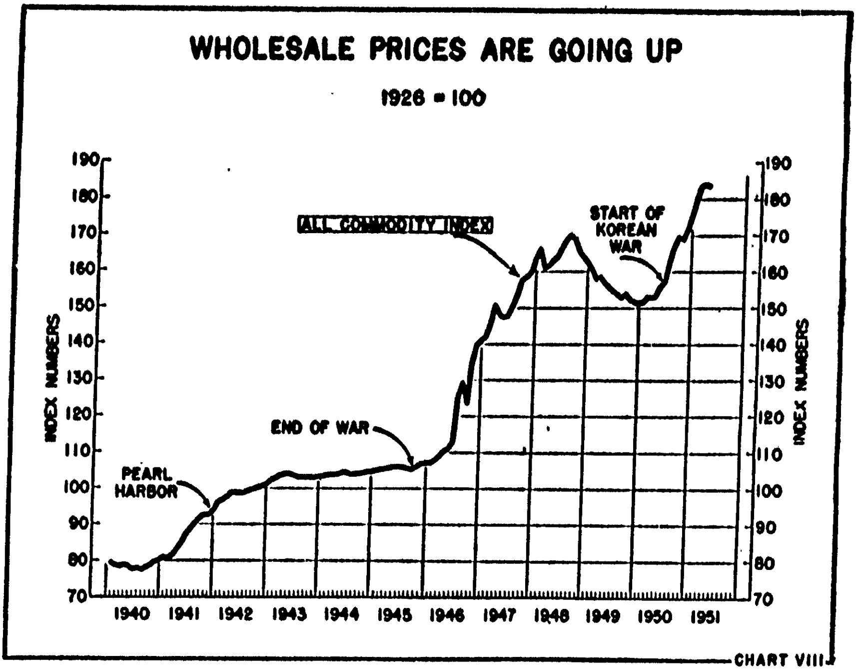


CHART VIII

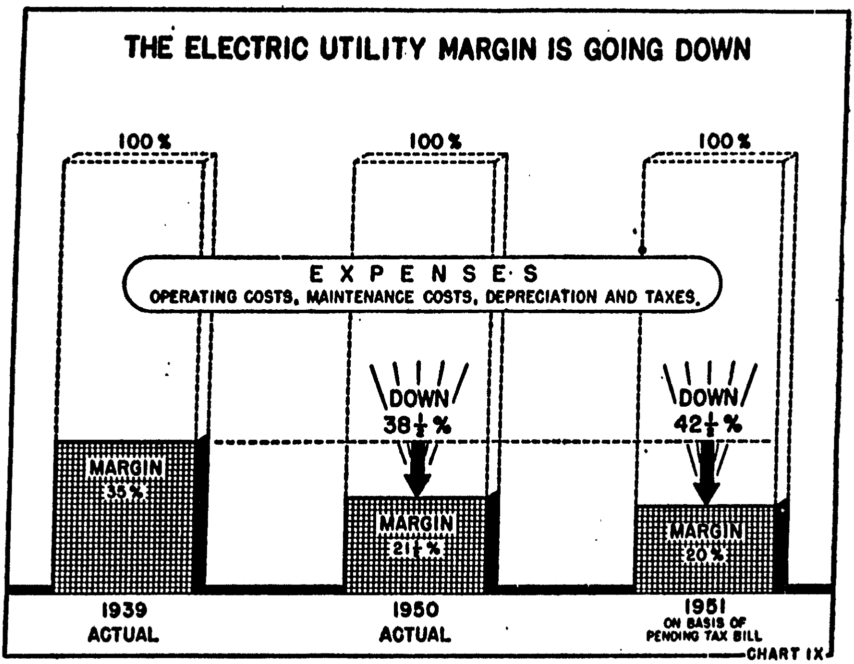


CHART IX

PERCENTAGE "MARGIN"‡ OF THE ELECTRIC COMPANIES WOULD BE LESS THAN GENERALLY ALLOWED BY COMMISSION REGULATION

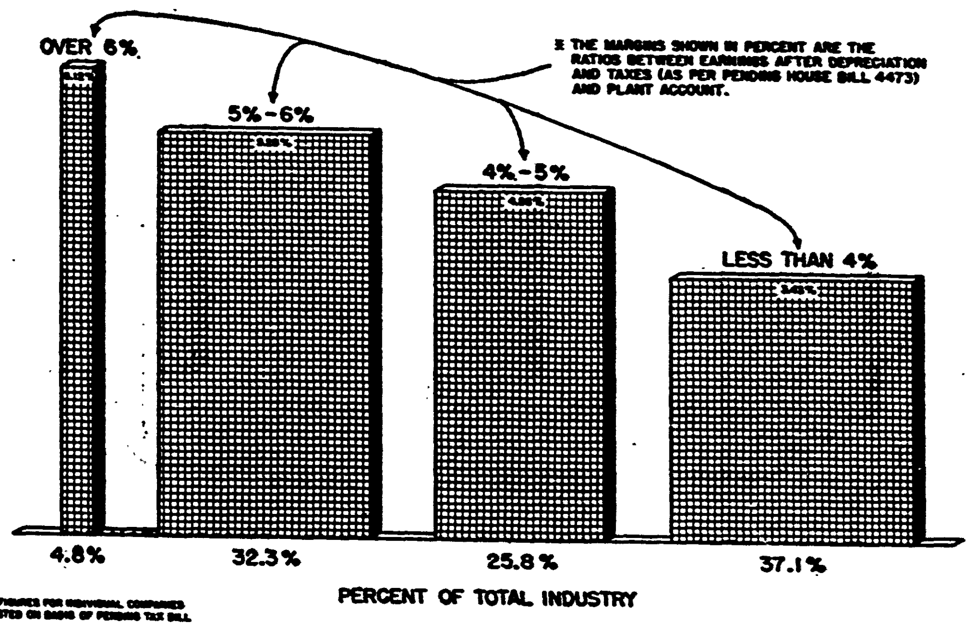
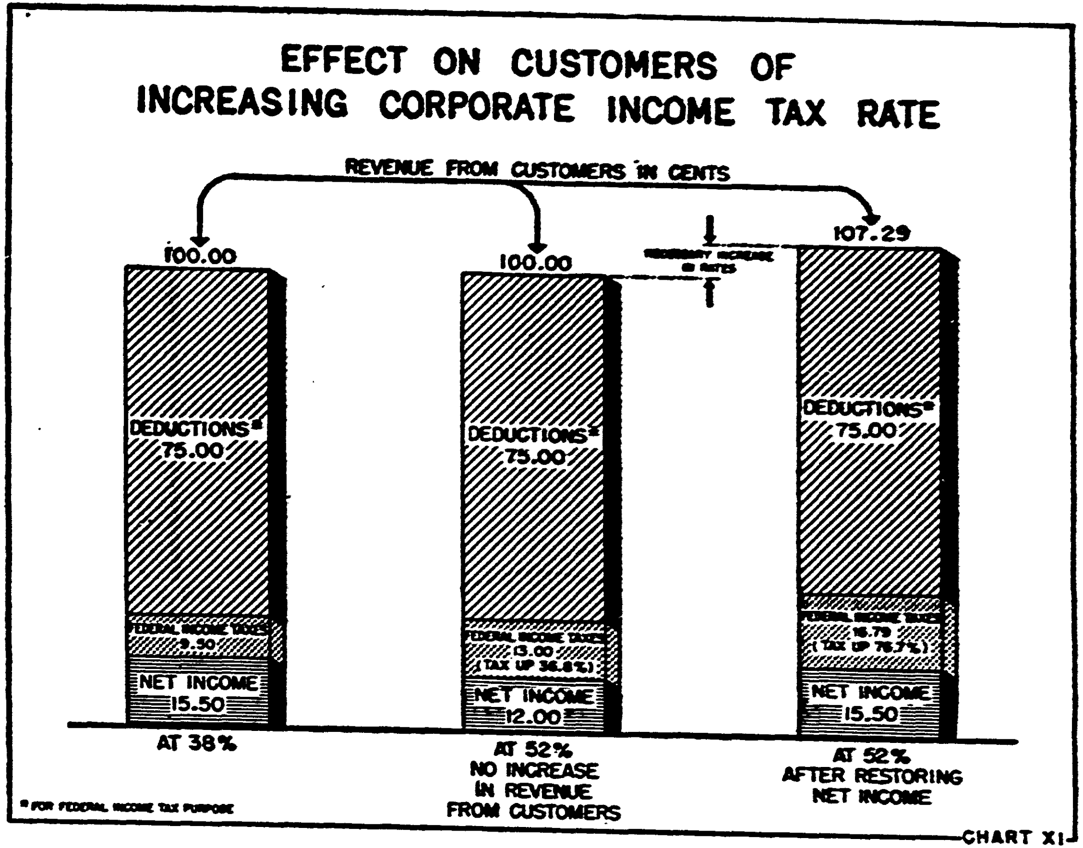


CHART X.


EFFECT ON CUSTOMERS OF
INCREASING CORPORATE INCOME TAX RATE
REVENUE FROM CUSTOMERS IN CENTS
100.00
DEDUCTIONS*
75.00
FEDERAL INCOME TAXES
9.50
NET INCOME
15.50
AT 38%
100.00
DEDUCTIONS*
75.00
FEDERAL INCOME TAXES
13.00
(TAX UP 36.8%)
NET INCOME
12.00
AT 52%
NO INCREASE
IN REVENUE
FROM CUSTOMERS
107.29
DEDUCTIONS*
75.00
FEDERAL INCOME TAXES
16.79
(TAX UP 76.7%)
NET INCOME
15.50
AT 52%
AFTER RESTORING
NET INCOME
* FOR FEDERAL INCOME TAX PURPOSE
CHART XI

NEW YORK TIMES
MAY 29, 1951

1951 DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS **1951**

FORM 1040-ES AND INSTRUCTIONS

$3 Billion Income Tax Rise Advances

House Unit Tentatively Votes 3-Point Increase

Family Fortunes

"Mr. Z" Feels Growing Fiscal Pinch Despite $35,000-a-Year Income

Taxes, Education for Kids, So Roasts Sabotage His Savings For Retirement

Fewer Tailor-Made Suits

MIDNIGHT IS DEADLINE FOR U.S. TAX RETURNS

HOUSE UNIT VOTES HIGHER INCOME TAX EFFECTIVE SEPT. 1

In Another Tentative Decision, It Favors Corporate Rise Retroactive to Jan. 1

SHORT OF TRUMAN'S GOAL

Committee For Straight 12½% Income Tax Rise

House Group Revises Bill to Aid Low Brackets; Industry Levy Is Raised

THERE is still time to reduce your taxable income before amending your 1951 tax estimate.

The interest on State and Municipal bonds is exempt from all present Federal Income Taxes (normal and surtax).

A husband and wife in the $8 12,000 surtax net income bracket must secure a yield from corporate securities of over 4½% to equal the *tax-exempt* 3½% yield of a municipal bond. *Those in the $44-52,000 bracket must purchase taxable securities yielding over 7½% to secure the equivalent net return of a municipal bond yielding 3½%.* And there are many indications that income tax rates will go higher thus increasing the advantage in owning State and Municipal obligations. Corporations also enjoy distinct advantages in owning *tax-exempt* securities.

Here is an unusual opportunity to purchase well secured, *tax-exempt* bonds issued for the purpose of supplying more electric energy to the power-hungry Northwest.

Interest exempt from all present Federal Income Taxes

Public Utility District No. 1 of Chelan County, Washington

ROCK ISLAND HYDRO-ELECTRIC SYSTEM
3.50% ELECTRIC REVENUE BONDS

Due July 1, 2005

PRICE 100%
(accrued interest to be added)

(Descriptive circular available)

BLAIR, ROLLINS & CO. *Incorporated*

44 Wall Street, New York

Offices in many principal cities

CHART XII.

THE INDIVIDUAL INVESTOR IS SECURING LESS AND LESS OF HIS INCOME FROM DIVIDENDS ON CORPORATE SECURITIES

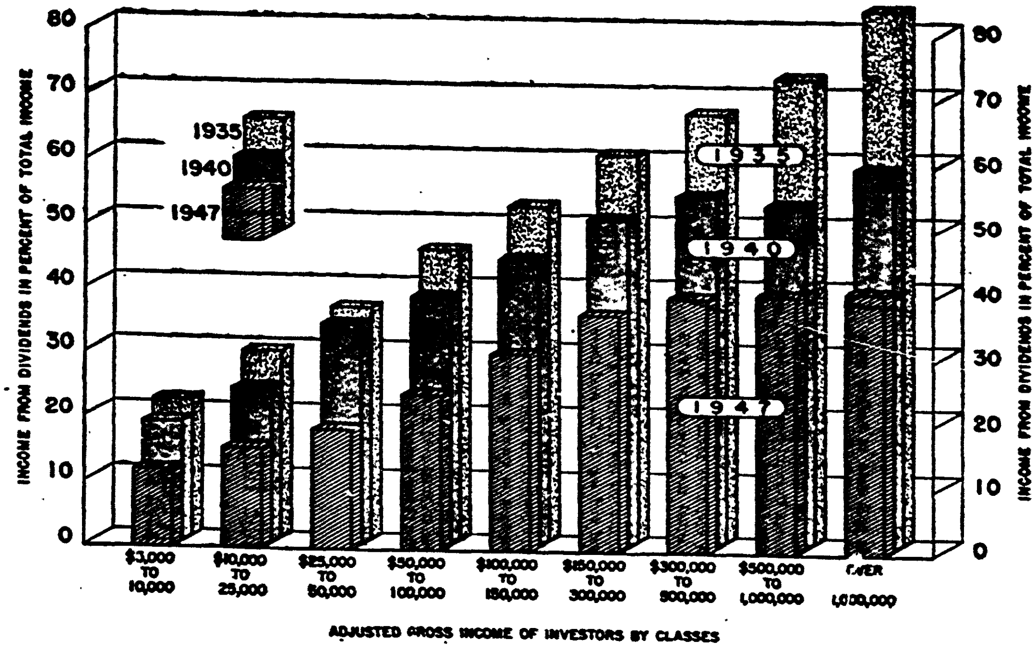
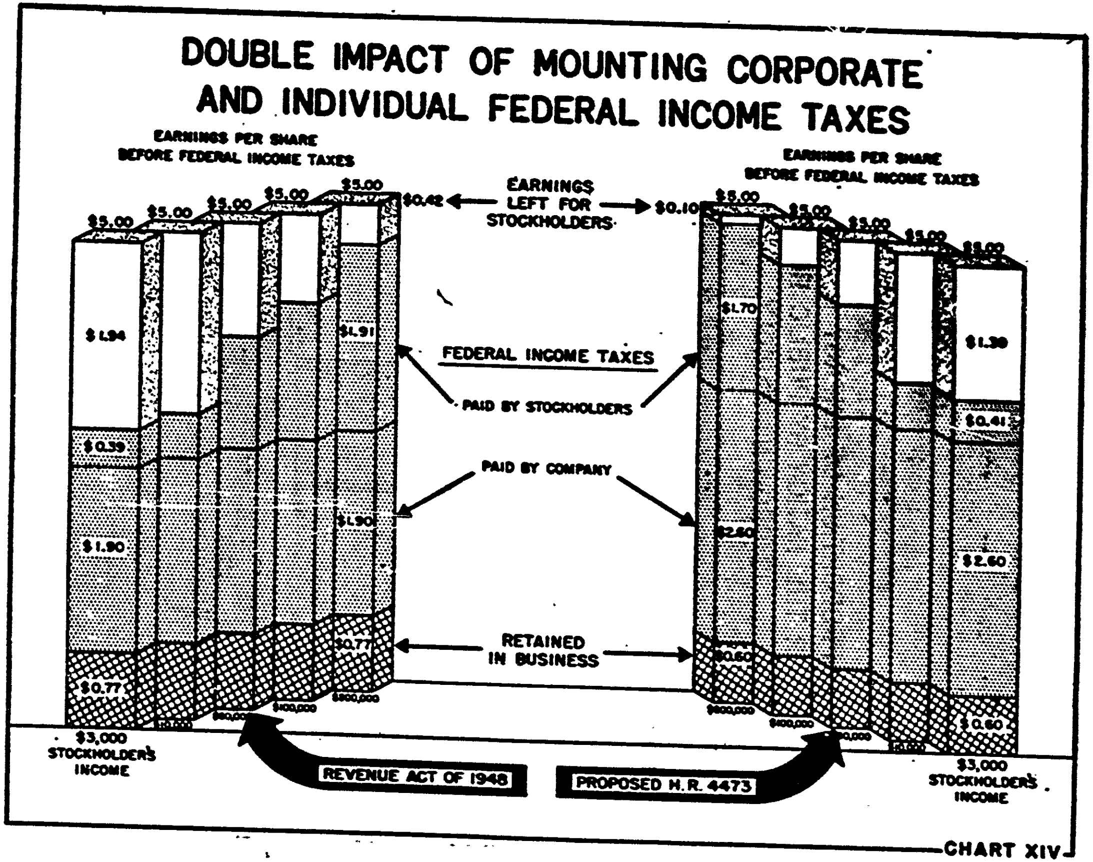


CHART XIII


DOUBLE IMPACT OF MOUNTING CORPORATE AND INDIVIDUAL FEDERAL INCOME TAXES
EARNINGS PER SHARE BEFORE FEDERAL INCOME TAXES
EARNINGS PER SHARE BEFORE FEDERAL INCOME TAXES
$5.00
$5.00
$5.00
$5.00
$5.00
$0.42
EARNINGS LEFT FOR STOCKHOLDERS
$0.10
$5.00
$5.00
$5.00
$5.00
$5.00
$1.94
$0.39
$1.90
$0.77
$1.91
$1.90
$0.77
FEDERAL INCOME TAXES
PAID BY STOCKHOLDERS
PAID BY COMPANY
RETAINED IN BUSINESS
$1.70
$2.60
$0.60
$1.30
$0.41
$2.60
$0.60
$100,000
$800,000
$800,000
$400,000
$3,000 STOCKHOLDER'S INCOME
$3,000 STOCKHOLDER'S INCOME
REVENUE ACT OF 1948
PROPOSED H.R. 4473
CHART XIV

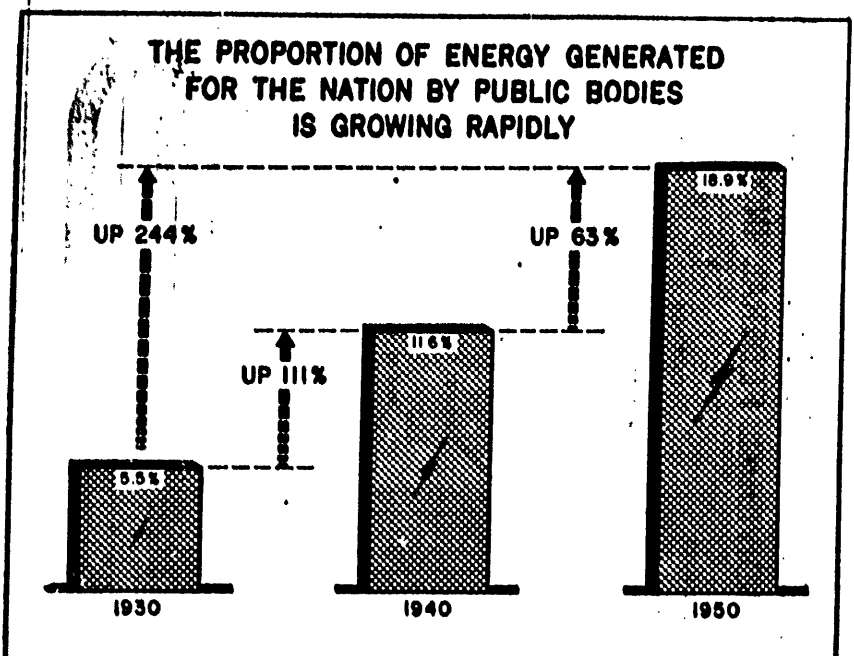

THE PROPORTION OF ENERGY GENERATED
FOR THE NATION BY PUBLIC BODIES
IS GROWING RAPIDLY
UP 244%
UP 63%
UP 111%
18.9%
11.6%
5.5%
1930
1940
1950

CHART XV

FEDERALLY FINANCED POWER PROJECTS

IN SERVICE, UNDER CONSTRUCTION, AUTHORIZED, APPROVED AND PROPOSED

631 PROJECTS TOTALING 56,390,425 KW

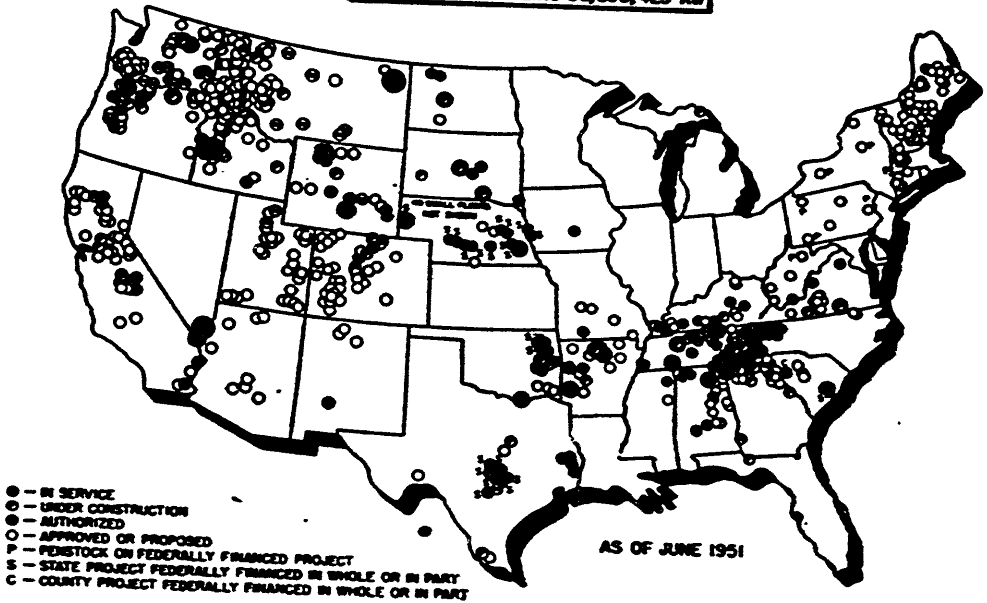
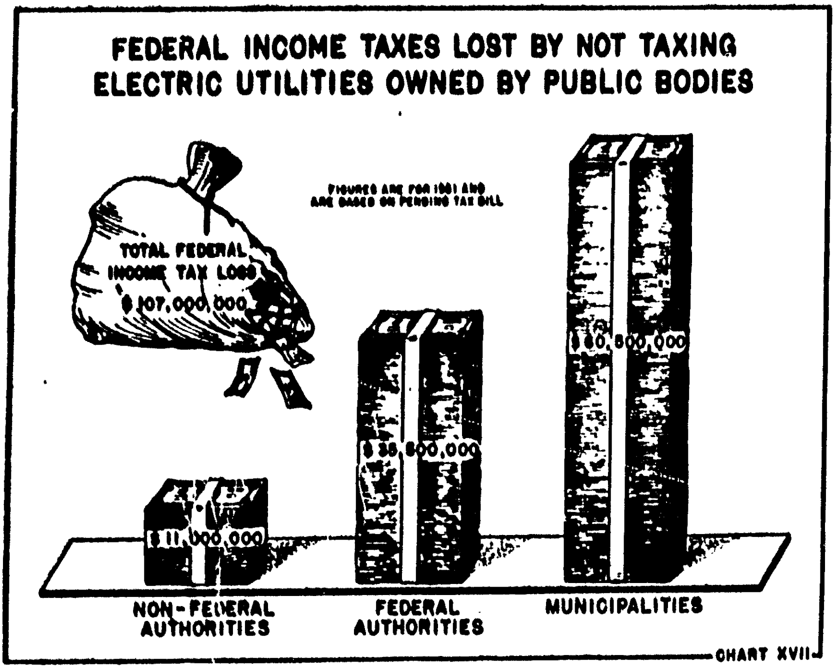


CHART XVI


FEDERAL INCOME TAXES LOST BY NOT TAXING
ELECTRIC UTILITIES OWNED BY PUBLIC BODIES
FIGURES ARE FOR 1951 AND
ARE BASED ON PENDING TAX BILL
TOTAL FEDERAL
INCOME TAX LOSS
$107,000,000
$11,000,000
$35,500,000
$60,500,000
NON-FEDERAL
AUTHORITIES
FEDERAL
AUTHORITIES
MUNICIPALITIES
CHART XVII

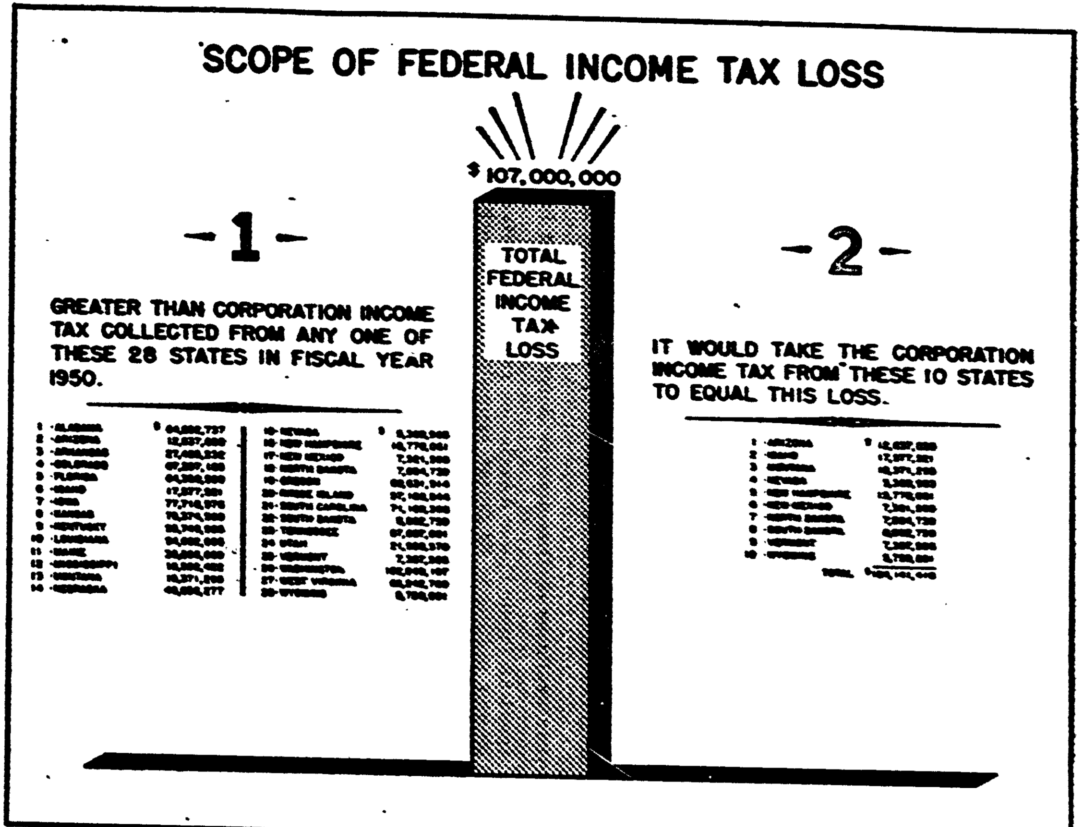
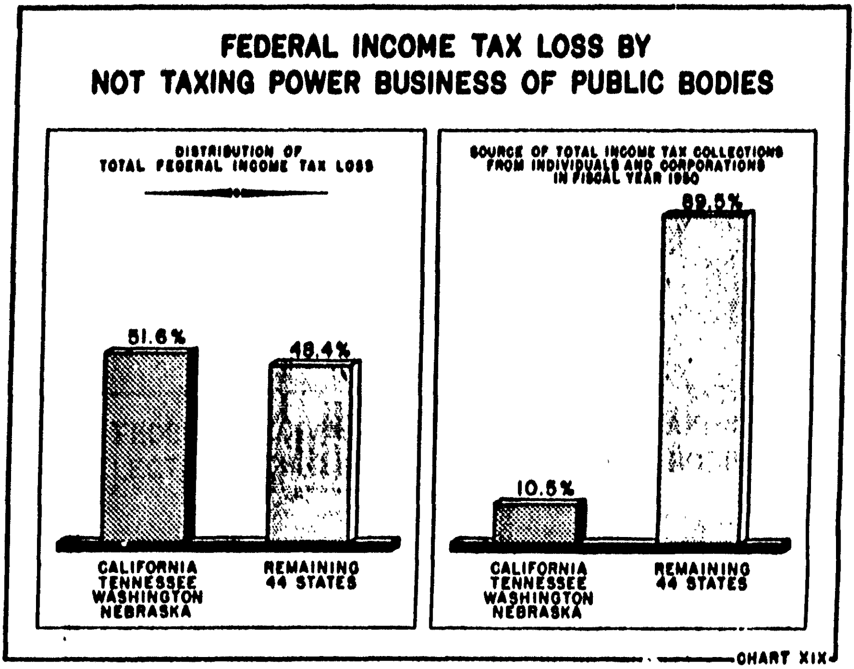

SCOPE OF FEDERAL INCOME TAX LOSS
$ 107,000,000
TOTAL FEDERAL INCOME TAX LOSS
-1-
GREATER THAN CORPORATION INCOME TAX COLLECTED FROM ANY ONE OF THESE 28 STATES IN FISCAL YEAR 1950.
-2-
IT WOULD TAKE THE CORPORATION INCOME TAX FROM THESE 10 STATES TO EQUAL THIS LOSS.

CHART XVIII



STATEMENT BY BOARD OF DIRECTORS OF AMERICAN PUBLIC POWER ASSOCIATION[1]

The American Public Power Association, representing over 700 local publicly owned electric utilities in 33 States, appreciates the opportunity to insert this statement in the record of the hearings by the Senate Finance Committee on H. R. 4473, the Revenue Act of 1951.

In his statement before this committee on August 1, Mr. Charles E. Oakes, chairman of the special tax policy committee of the Edison Electric Institute, asked that the Federal corporate income tax be extended to the publicly owned electric utilities.

The American Public Power Association is fully sympathetic with the need of the Congress to seek additional sources of revenue at this time. However, we cannot believe that the need for additional revenue is so great that the Congress would endanger one of the basic tenets of our Constitution in order to obtain this revenue. Yet that is precisely what would result if the Congress sought to impose the Federal corporate income tax on the publicly owned electric systems. Such a tax would strike a blow directly at the historic principle of reciprocal immunity from taxation, one of the fundamental principles of our form of government. Whether, as Chief Justice Marshall said, "the power to tax is the power to destroy," the power to tax is surely the power to control, and the establishment of a precedent of Federal taxation on State and local governments would be a Federal power to control the lifeblood of local government. At a time when there has already been a serious invasion of the prerogatives of State and local governments, these local governmental units cannot afford a further weakening of their powers.

Aside from the doubtful constitutionality of a Federal tax on publicly owned electric systems, there are other compelling reasons why such a tax would be unwise. Local governmental units today are in dire financial condition. In some 2,700 communities throughout the country the financial condtion of the local governmental units is being alleviated to some extent by the contribution to the local governments by the municipally owned electric plants. The extent of this contribution to local governments was indicated in a study made in 1948 by the American Public Power Association.[2] This study showed that the publicly owned elec-

[1] Adopted at meeting in Washington, D. C., August 6.
[2] Public Power Pays! Copyright 1948 by the American Public Power Association.

tric systems were already making substantial contributions to local government, and in many communities this contribution greatly exceeded the 10 cents in taxes of all types which Mr. Oakes said the privately owned utilities were paying, in 1949, out of each dollar of revenue. The contribution of municipal utilities to local government even exceeded the 23.23 cents out of each dollar of revenue which Mr. Oakes said the privately owned utilities would pay in taxes under the pending bill. This fact removes the foundation from Mr. Oakes' charge that the customers of the privately owned utilities are being discriminated against, insofar as the burden of taxation is concerned.

Contrary to Mr. Oakes' charge of tax discrimination the customers of the privately owned companies might well claim that they suffer from a different kind of discrimination since they generally pay more for the electricity they use, and the profits of the system go to private individuals, rather than to the communities which are served by the electric properties. Mr. Oakes does not ask Congress for relief for the customers of the privately owned utilities from this form of discrimination, because presumably the people involved prefer that kind of service.

Of course, Mr. Oakes' charge that the alleged tax discrimination threatens the very existence of the electric companies is fantastic. Public bodies which have bought privately owned electric utilities have done so by exercising their choice based on good and sufficient reasons. This is an exercise of self-government by local subdivision which constitutionally has always been free from taxation by the Federal Government. It should remain so.

It is noted that, following Mr. Oakes' testimony, Mr. John H. Hessey, representing the National Association of Railroad and Utilities Commissioners, also testified before this committee, and requested that a Federal excise tax be levied against the customers of all utilities, regardless of their type of ownership. The House Ways and Means Committee, in its consideration of H. R. 4473, eliminated the 3⅓-percent Federal electric energy excise tax from the privately owned utilities. It also reversed an earlier tentative action in which it recommended that this tax be extended to the publicly owned utilities. We ask the Senate Finance Committee to sustain the action of the House in not extending this excise tax to the publicly owned electric utilities, for the reason that such a tax, like a Federal corporate income tax, would seriously threaten the separation of powers between the Federal Government, on the one hand, and State and local governments on the other.

We also ask this committee to reject the recommendation made July 18 by Mr. Herschel D. Newsom, master of the National Grange, that the Federal income tax be applied to earnings from State and local bonds. The position of our association on such a tax is stated in detail in the accompanying statement which was presented on February 27, 1951, by Mr. Northcutt Ely, general counsel of APPA, before the House Ways and Means Committee.

Senator BYRD. Mr. Burton P. Smith.

STATEMENT OF BURTON P. SMITH, AMERICAN GAS ASSOCIATION

Mr. SMITH. Mr. Chairman and gentlemen, my name is Burton P. Smith. I reside in Shreveport, La. I am the in-coming chairman of the taxation committee of the American Gas Association.

I appear before this committee on the behalf of the American Gas Association, an organization that represents over 90 percent of the manufactured and natural gas public utility and gas pipeline companies in this country.

In the interest of conserving time—the time of your committee—we respectfully request that there be inserted in the record of these hearings a copy of a letter with respect to H.R. 4473.

This letter is addressed to your chairman, Senator George, by Mr. George S. Young, acting chairman of the national defense committee of the American Gas Association.

Senator BYRD. Thank you, Mr. Smith.

Mr. SMITH. Thank you very much.

(The letter referred to follows:)

AMERICAN GAS ASSOCIATION,
New York 17, N. Y., August 1, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senator Finance Committee,
Washington, D. C.

SIR: The American Gas Association is an industry organization that represents over 90 percent of the manufactured and natural gas public utilities and gas pipeline companies in this country. This industry, as a whole, serves approximately 24 million customers, employs 176,400 workers and has assets amounting to $9.3 billion.

There is now before you H. R. 4473, the Revenue Act of 1951. We have carefully examined this bill and will limit our comments to those sections of the bill that we believe directly affect our industry. In stating our views, we wish to make it clear that we seek no special consideration or preferential treatment apart from other industries in general.

Specifically, our comments are as follows:

INCREASE IN CORPORATE RATE (SEC. 121 OF H. R. 4473)

We are particularly concerned with the proposed increase in the corporation income tax rate to 52 percent. The present 47-percent rate represents a 24-percent increase over the 38-percent rate effective in 1949, just 2 years ago. The proposed rate of 52 percent would be a 37-percent increase over the 1949 rate.

Such substantial increases gravely disturb existing economic conditions in the gas industry. In our industry retained earnings are small and it has already been necessary for many gas utilities to seek increased rates from their customers as a result of the rise in corporate income taxes levied by the Revenue Act of 1950. A further increase in the corporate rate to 52 percent as in H. R. 4473 will force most of the industry to petition the regulatory authorities for an increase in customers' rates. The only alternative would be to reduce the amounts available to workers or to investors. Neither is a practical solution. Inflationary pressures on the workers make any reductions in their wages impossible. On the other hand, to reduce payments to investors would make it more difficult for the industry to secure adequate amounts of capital required by our currently large construction programs.

In cases where regulatory authorities permit an increase in rates to customers to compensate the utility for higher income tax, the rate increase must be almost double the amount of the higher tax. For example, with the present 47 percent rate it takes, exclusive of the effect of local and State taxes, $1.89 of taxable income to produce $1 of net income. Should the rate be increased to 52 percent, $2.08 of taxable income would be needed to pay the tax and leave $1 of net income. Thus the proposed rise of 5 percentage points in the tax rate would mean adding 19 cents to the customers' bill for each $1 of net income of the corporation. For this reason we believe that the corporation income-tax rate should not be increased above 47 percent except as a last resort.

Our comments with respect to the increase in the corporation income tax apply also to the proposed increase in the excess-profits tax through the reduction in the credit based on income from 85 to 75 percent of average earnings (sec. 502 of H. R. 4473).

RETROACTIVE INCREASE IN CORPORATE RATE

The gas business is largely seasonal with large sales during the winter months and lower sales during the summer. Much of 1951 has already passed and with it most of the winter weather of the calendar year 1951. The taxable income that will be produced during the remaining months of the year is only a small part of the total income for the year. If the corporation income-tax rate is increased retrocatively to January 1, 1951, the amount of income that will be produced in our industry in the last few months of the year will be heavily burdened to provide for such retrocative increases. In most cases the rates that we are now charging our customers have not been adjusted to provide for the tax increases that have already occurred. A retroactive tax increase at this time would only aggravate this situation.

SURTAX EXEMPTION TO CORPORATIONS (SEC. 123 OF H. R. 4473)

The proposed limitation of one surtax exemption of $25,000 for all members of a controlled group of corporations is primarily aimed at removing the incentive for the artificial splitting of corporations to obtain additional surtax exemptions. Corporations not created for this purpose should not be penalized. It is, therefore, suggested that where corporations of a controlled group exist or are created for valid business purposes, this limitation should not be applicable.

COLLECTION OF INCOME TAX AT SOURCE ON DIVIDENDS, INTEREST, AND ROYALTIES (SEC. 201 OF H. R. 4473)

(*a*) *Acceleration of refunds*

Many of our security holders are people with incomes that are less than their personal exemptions and allowable deductions. Withholding on dividend and interest payments to these individuals may cause severe hardship and we strongly urge that some means be provided to accelerate the refunds of withholdings to these people.

(*b*) *Intercorporate dividends*

Withholding on dividends, certain interest, and royalties (including lease rentals and bonuses) is proposed under this section to prevent the loss of tax through unreported income. Exemption from withholding is provided where the dividends or interest are paid by a corporation to another affiliated corporation, but only if both corporations are included in a consolidated return for the preceding taxable year. Exemption should also apply to all intercorporate payments of dividends and interest since there is no loss of tax from this source; also the withholding exceeds the tax liability in the case of dividends. If such a withholding provision is to be included in the bill, the corporation receiving the dividend should be permitted to take an immediate credit (approximately 13 percent at the present 47-percent income-tax rate) equal to the excess withholding against any internal revenue tax due.

Respectfully submitted.

GEORGE S. YOUNG,
Acting Chairman, National Defense Committee.

Senator BYRD. Mr. Hessey, will you please identify yourself?

STATEMENT OF JOHN HESSEY, CHAIRMAN, MARYLAND PUBLIC SERVICE COMMISSION

Mr. HESSEY. Yes, sir.

My name is John Hessey, chairman of the Public Service Commission of Maryland. My office is in the Munsey Building, Baltimore, Md.

I appear here on behalf of the National Association of Railroad and Utility Commissioners of the United States, generally referred to as NARUC, representing all of the State commissions which are members of our body.

I do not speak on behalf of any of the Federal commissions; I am speaking only on behalf of all the State regulatory bodies.

Now, the executive committee of the national association adopted a resolution on March 2, 1951, advocating that additional taxes levied by Congress upon the operations or services of regulated public utilities take the form of an excise tax, in order that existing rate structures might be continued; and that such taxes fall alike upon all users of the services of all utilities, regardless of the nature of their ownership or operating organization.

Now, I have attached to this copy of my statement a copy of the resolution which has been adopted.

This national association, of course, is fully cognizant of the need which the Congress faces to raise revenue by taxation, and it does not oppose its efforts to raise the necessary funds.

But, of course, the Association of Regulatory Commission, which, of course, has to regulate the rate charged to the public by all companies, such as gas, electric, communications, water, and all other public utilities, is nevertheless very vitally interested in the method by which that money is obtained.

I might say that patrons of utility companies have in the last few years, of necessity, been subjected to an increase in rates, chiefly because of increased labor costs and material costs, and also because of higher taxes.

We feel that the time has come when that mounting spiral should cease and that the commission should not be required, as a matter of law, to increase rates.

It is, of course, primarily the duty of the commissions to serve the people in their respective jurisdictions, and to render decisions primarily for the benefit of the people.

You may, therefore, say we should not increase rates. I want to say that there is also a corresponding duty which requires the commissions to allow a regulated utility a reasonable return on the fair value of its property, used and useful, in the interest of the public.

If we fail in that duty, we would be exercising unconstitutional authority, and what we would be doing would amount to the taking of private property without just compensation, and that we are not permitted to do.

Any additional tax imposed upon regulated public utilities will, generally speaking, reduce their net income below the amount which the State regulatory commissions have fixed as a fair and reasonable return to the utility.

Therefore, if an increased income-tax rate is made applicable to regulated utilities, it would be mandatory—mind you, we would have no discretion—it would be mandatory on the several State commissions to allow an increase in rates in order to enable them to earn enougth to pay the taxes and to make a reasonable return.

Now, upon a failure to do so, we are immediately taken to court, and the courts overrule us and direct us to do it. We, of course, are not unmindful of the duties imposed upon Congress, but we respectfully submit that Congress, by its action, should not create a situation whereby customers would be saddled with rate increases throughout the Nation.

Commissions, of course, are directly responsible to the public whom they serve and you naturally can understand that great criticism is thrust upon the commission each time they increase the rates.

They do not understand that the action is made necessary by the action of Congress. All they see is an increased rate, and the commissions in the several States have to bear the brunt of it.

Now, we favor an excise tax to be paid by the patrons of all utilities.

If you do that, then we would not have to increase the rates. That seems to us to be a just and fair solution.

To assess additional taxes against regulated utilities would require them to collect more than double the amount of taxes from their customers, and all of this additional sum would be paid to the Government.

Senator MILLIKIN. Will you make that a little clearer?

Mr. HESSEY. Yes, sir. I will be glad to.

I have an illustration attached to the prepared statement which has been filed.

Senator MILLIKIN. In other words, the question suggests itself whether there is any difference between raising the rate by the local utilities commissions so far as the consumer is concerned, and requiring the consumer to pay an excise tax?

Mr. HESSEY. Well, if you raise the rates, he has to pay double. If you have an excise tax he can pay singly, that is all.

Senator MILLIKIN. That is what I would like to have explained.

Mr. HESSEY. If the rate is increased—let us assume that the corporation had to pay or the utility had to pay $1 million more in taxes. That would reduce the net earnings by 1 million.

In other word, to get back that $1 million we would have to increase the rates $2 million.

Senator MILLIKIN. Why?

Mr. HESSEY. Because, assuming that they had earned 10 million, if you make the rate 50 percent and they earned 2 million more, they pay 1 million in additional taxes, and that, with the 1 million that you make them pay because of an increased rate on the prior 10 million, requires us to double, to raise the rates double.

There is no escape from that proposition, none whatsoever, sir. And I will give you the analysis of it, sir.

If you increase the rate--you understand, when you increase the rates, you subject that increase also to the State taxes, as well as to the Federal taxes.

Senator MILLIKIN. I understand that this has been gone into with the previous witness, so I shall not pursue it any further.

Senator MARTIN. No, wait a minute; it is well worth while.

Mr. HESSEY. I am in here in the other position. Do not put me in with the utilities. We are the fellows who have to fix the rate.

Senator BYRD. Your explanation is the same as that of the other gentleman.

Mr. HESSEY. It could not be otherwise.

Senator WILLIAMS. If you reverse this procedure and strike this 3⅓ off, does that mean that the rates will go down 6 percent?

Mr. HESSEY. Assuming, sir—let me say this to you, sir, assuming—you do not increase the tax, we will see that the public gets the benefit of it, sir.

Senator WILLIAMS. I mean, does it work in reverse? Does it work that way?

Mr. HESSEY. It works in reverse and it helps us tremendously, if you take that off, because it increases the earnings by that amount of money and you can rest assured that the several regulatory bodies are looking for all the increased earnings that they can get so we do not have to raise the rates, and it would be a happy day if we could decrease the rates at the present time.

Senator BYRD. I have not understood yet--I was called out—about an excise tax. What did you mean by that?

Mr. HESSEY. I mean a tax levied upon the consumer. Instead of saying, "Mr. Consumer, here you have been paying $10 on your bill—instead of paying $20, you pay an excise tax of $12," which would be the amount necessary, we will say, because of the increased rate, "you will pay an excise tax of $1." Then, there is no additional earning there to the corporation on which they pay taxes.

You give it to the corporation—it is an increased earning, and then you just take it away in taxes.

Senator MILLIKIN. What excise taxes of that character does the consumer now pay for in the States?

Mr. HESSEY. I do not believe there are any, sir, of the kind that the consumer pays. I know of none at the moment.

I am talking about now the State excise taxes. Of course you well know of all the excise taxes they pay for the benefit of the Government on the various articles, and things of that kind.

Senator MILLIKIN. I am talking about State and local excise taxes on this same commodity.

Mr. HESSEY. There is, I believe, some excise tax paid by the utilities perhaps, in a few instances to the counties or the cities, some tax, but it is not paid directly.

Senator MILLIKIN. I am talking about that paid by the consumers.

Mr. HESSEY. You mean the customers themselves?

Senator MILLIKIN. The consumers.

Mr. HESSEY. I know of none at the moment. Of course, I have followed here with reference—I was leading up there to the question of showing what the increased rates would have to be, and as we have discussed that, I will omit that reference to it.

Now, our argument is, why force regulated public utilities to apply to State regulatory bodies for mandatory increases requiring the customers to pay more than double the tax which Congress seeks to secure by an increase in the income-tax rate? We say the answer is obvious.

Now we, therefore, most respectfully urge that the income-tax rates for public utilities be not increased, but that an excise tax be levied upon the consumer who, in the final analysis, furnishes the money with which the income tax is paid.

We are saying that for the benefit of the consumer and the public——

Senator BYRD. That excise tax would be on a percentage basis?

Mr. HESSEY. Yes, sir.

Senator BYRD. In other words, if you had a $10 bill you would pay how much tax?

Mr. HESSEY. Well, that is the question that I would assume that the experts of this committee would be in a better position to judge the amount of it than I.

Anticipating, however, that such a question might be asked, I have had a number of computations made, and they, generally speaking, average three-fourths of 1 percent for each 1-percent increase in the tax rate, so that if you increased from 47 to 52, it would be about a 1½-percent excise tax.

Senator BYRD. You tax the consumer directly?

Mr. HESSEY. Direct. Instead of making him——

Senator BYRD. And that avoids a tax on the corporation.

Mr. HESSEY. I am not thinking about avoiding a tax on the corporation. I am thinking about our duty from a regulatory standpoint.

Senator BYRD. It avoids an increase of rates on the corporation, on which the corporation would have to pay a 52-percent tax.

Mr. HESSEY. No doubt about that, sir.

Senator BYRD. You think that is a better plan that increasing the rates, the excise tax would be a better plan?

Mr. HESSEY. Well, I do, in that it makes the task of the commissioners of all these States much easier, and I think the question was asked of the previous witness whether or not applications had been made already.

I might say that before our own commission we already have one from our telephone company, and in that they have referred to the pending tax bill, and they have gotten it in there in the hope that they can have a hearing upon it immediately after action by Congress so that there will not be the apparent lag between the time the tax is imposed and the time it could become effective—the rate increases could become effective.

Senator HOEY. Your position is that it would cost the consumer just half as much?

Mr. HESSEY. Just half as much; yes, sir.

Senator MILLIKIN. Would the utilities collect the tax for the Government?

Mr. HESSEY. Yes, sir. I see no other way. They would have to put it on the bill and collect it and remit it.

Senator BYRD. Could it be a uniform tax? It could not be a uniform tax. Your idea is for the Federal Government to authorize a tax, and a percentage of that tax be fixed by the local commission?

Mr. HESSEY. No, sir; not at all. That tax must be fixed by Congress; that is not our prerogative.

Senator BYRD. How could you fix a uniform tax?

Mr. HESSEY. Well, on——

Senator HOEY. On a percentage basis?

Mr. HESSEY. As I say, I have made only a few checks on it, and they seem to indicate, as I say, three-tenths of 1 percent.

Now those are, I think, three different industries. It may not apply to all, but an excise tax—I was coming to my next point—if you levy an excise tax, you get the customers of all cooperatives and all Government-owned utilites paying a tax.

If you just impose a tax upon the utilities without placing it on the customers, then you make many customers over the country pay double, and you let customers of special interests pay nothing.

Senator BYRD. I see a good deal of merit to it, but I do not just see how you can have a uniform tax for the electric companies and telephone companies, and all the others.

Mr. HESSEY. I think, when you find the facts, if a study is made, that, perhaps you can come up with the appropriate answer. I think that one of those that I had was a telephone company; one was a gas company; I think that one was a water company, and the variation was less than one-half of 1 percent when you went up to a tax rate of 55 percent. So, we are suggesting that, instead of increasing the rate on regulated public utilities, you require their consumers to pay or their customers to pay.

Senator BYRD. Of course, the Federal Government would now lose its share that they are now getting of increased taxes.

Mr. HESSEY. What is that?

Senator BYRD. The Federal Government would lose——

Mr. HESSEY. They would not lose anything if they did that.

Senator BYRD. I mean, they would lose their share of revenue that would be permitted by the utilities commissions; they would lose the 52 percent that you are speaking of.

Mr. HESSEY. They would not lose anything.

Senator BYRD. They would not lose anything right now. If you have got to raise the rates $1,000,000, for example, then the Federal Government gets $500,000 of it.

Mr. HESSEY. That is right.

Senator BYRD. You are trying to avoid that and, therefore, the Government would lose its share of these new rate increases that would be allowed; is that not correct?

Mr. HESSEY. No; I am giving you enough—as much by excise taxes as you would get by the increased rates so you cannot lose anything if you get as much one way as you would get the other.

The only thing is that you make the customers of the public utilties pay; that is all I am saying that you do. They pay double, whereas, if you put an excise tax on it, you would get the same amount of the tax.

Senator FREAR. Where does that money go if you are going to collect $2,000,000 from the customer and the Government gets only $1,000,000? That other million must go somewhere.

Mr. HESSEY. Well, of course, the Government gets it all. You could figure out what the Government is entitled to receive. The Government is trying to get the taxes on the earnings of the corporation.

Now, then, by the action of the Government it gets that money, but it forces those to come back to us, and then, after that, we increase rates and it keeps on pyramiding all the time; that is what happens.

Senator HOEY. What Senator Byrd meant was that, if you increase the amount to make $1,000,000, then you say it is necessary to increase it by $2,000,000.

Mr. HESSEY. That is right.

Senator HOEY. Of course, the Government gets both of those 2 million dollars?

Mr. HESSEY. Yes, sir.

Senator HOEY. It costs the consumer quite a lot more—twice as much, but the Government does get it.

Mr. HESSEY. It does get it, but I do not think the Government should require all the regulated utilities to do it. You are passing it on to the public, and that is the only instance that I can think of where it goes directly——

Senator BYRD. It makes the Government lose its whole share.

Mr. HESSEY. I think the answer to that is that there is discrimination with respect to that particular class of people, and there should not be any discrimination.

Senator BYRD. I am not talking about that, but I just want to get the whole picture of what you propose to do.

Mr. HESSEY. I agree with you.

Senator BYRD. The Government, or someone, has got to come in with this 50 percent that you are talking about. The Government loses this 50 percent.

Mr. HESSEY. Yes, sir, but you see, these other companies that are earning money, the difference is this: The regulated utility is only permitted by law to earn a certain rate of return.

All these other corporations that you read about are making the fabulous sums and, perhaps, they will not like my saying it, but they can well stand it out of that, their earnings; but these companies cannot, and that is the difference.

Senator BYRD. What do you mean by "these"?

Mr. HESSEY. I mean the public-utility companies cannot; that is what I mean. That is all I am thinking about.

Public utility companies; those that we regulate, and I am speaking from that standpoint, and that standpoint only.

Senator BYRD. Thank you very much, Mr. Hessey.

Your statement will be placed in the record.

(The prepared statement referred to follows:)

STATEMENT OF JOHN H. HESSEY, CHAIRMAN, MARYLAND PUBLIC SERVICE COMMISSION

My name is John H. Hessey. I am chairman of the Public Service Commission of Maryland. My office is in the Munsey Building, Baltimore, Md.

I appear here today on behalf of the National Association of Railroad and Utilities Commissioners of the United States, generally referred to as NARUC, representing all of the State commissions which are members of our body.

The executive committee of the national association adopted a resolution on March 2, 1951, advocating that additional taxes levied by Congress upon the operations or services of regulated public utilities take the form of an excise tax, in order that existing rate structures might be continued, and that such taxes fall alike upon all users of the services of all utilities, regardless of the nature of their ownership or operating organization. Attached hereto is a copy of the resolution to which your attention is invited.

The national association is fully cognizant of the current need which Congress faces to raise revenue by taxation, and it does not oppose its efforts to raise the necessary funds. As the National Association of Railroad and Utilities Commissioners is an association of regulatory commissions of this country, which are empowered to regulate the rates charged to the public by the gas, electric, communications, water, steam-heating, transportation, and other public utilities serving the American public, it is, nevertheless, vitally interested in the method by which those funds are obtained.

As the patrons of utility companies have, of necessity, already been subjected to numerous increases in rates, chiefly because of increased labor and material costs and higher taxes, it is imperative that no further increases be allowed. The mounting spiral of increased costs must cease.

It is the duty of the commissions to serve the people in their respective jurisdictions and to render decisions primarily for the benefit of the people, but there is a corresponding duty which requires the commissions to allow a regulated utility a reasonable return on the fair value of its property, used and useful in the interest of the public. To fail in this latter duty would be exercising unconstitutional authority, and would amount to taking private property without just compensation.

Any additional tax imposed upon regulated public utilities will, generally speaking, reduce their net income below the amount which the several State regulatory commissions have fixed as a fair and reasonable return to the utility. Therefore, if an increased income-tax rate is made applicable to regulated utilities, it would be mandatory on the several State commissions to allow an increase in rates, in order to enable them to earn a reasonable return. Upon a failure of the commissions to do so, resort could be had to the State and Federal courts, and such courts would be compelled to reverse the commissions.

We are not unmindful of the duty imposed upon Congress, but we respectfully submit that Congress, by its action, should not create a situation whereby consumers would be saddled with rate increases throughout the Nation. The commissions are responsible directly to the public, whom they serve, and criticism for the rate increases would be heaped upon the heads of the Commissioners who are forced to raise rates. The public would not understand that the action of the Commissioners was necessary because Congress has increased the tax rate.

The commissions favor an excise tax to be paid by patrons of all utilities. Such a tax would not require them to increase rates. This is a just and fair solution. To assess additional taxes against the regulated utilities would require them to collect more than double the amount of taxes from their customers, and all of this additional sum would be paid to the Government. This is unjust discrimination against regulated utilities; rather, it imposes a double obligation on the people (customers) themselves.

Illustrations are legion, but one will suffice.

Taking one public utility, The Chesapeake & Potomac Telephone Co. of Baltimore City, as an example, a tabulation has been prepared and is attached hereto, showing the additional gross revenues required to offset the effect of the various increases in the Federal income-tax rate from 47 percent to 55 percent. It will be noted therefrom that the additional gross revenues required to offset the effect of the increase in taxes is more than double the increased Federal income tax, when the income tax is increased to 49 percent. It will be further noted that, as the tax rate is increased upward from 50 percent, the additional gross revenues required to offset the effect of the increase in taxes goes up in greater proportion.

Why force regulated public utilities to apply to State regulatory bodies for mandatory increases requiring that customers pay more than double the tax which Congress seeks to secure by an increase in the income-tax rate? The answer is obvious. An excise tax levied upon the consumer in an amount sufficient to meet the estimated income to be derived from the public utilities is the answer.

I therefore most respectfully urge that the income-tax rates for regulated public utilities be not increased, but that an excise tax be levied upon the consumer who, in the final analysis, furnishes the money with which the income tax is paid.

The national association also takes the position that an excise tax should fall alike on all users of the services of all utilities, regardless of the nature of the ownership or operating organization of the utilities. If a tax is to be imposed upon one public utility, it should be imposed upon all. If it is not, then the customers of a cooperative group or a Government-owned utility would be favored, for neither such utility nor the consumer would pay any part of an increased income tax imposed for the welfare and defense of this country. There should be no discrimination between utilities, whatever their character, nor between the customers of any utilities.

The imposition of an excise tax would reach customers of cooperatives and Government-owned utilities, and those now paying nothing by way of income or excise tax would be subjected to a fair share of the tax and some of the discrimination which now exists would be eliminated.

Resolution Relating to Increases in Federal Corporate Income Tax

Whereas it has been necessary for the Congress of the United States to make substantial increases in corporation taxes, and further and greater increases are under consideration and seem probable; and

Whereas such taxes if levied would completely disrupt and destroy the present rate structures of the regulated public utilities of the country, and make it necessary to hold many thousands of hearings by regulatory authorities, with a consequent waste of time and money that would amount in total to a tremendous expenditure; and

Whereas regulated utilities are allowed to earn a reasonable return upon their investment, and no more, and all taxes are a deductible operating expense that is passed on to the users of the service; and

Whereas the present and proposed extremely high taxes dedicated largely to the national defense should be borne equally and impartially by all users of utility services: Therefore be it

Resolved, That additional taxes levied by Congress upon the operations or services of regulated public utilities take the form of an excise tax, in order that existing rate structures may be continued, and that such taxes fall alike upon all users of the services of all utilities, regardless of the nature of their ownership or operating organization.

Adopted March 2, 1951, at a regular meeting of the executive committee of the National Association of Railroad and Utilities Commissioners held at Washington, D. C.

The Chesapeake & Potomac Telephone Co. of Baltimore City—Additional gross revenues required to offset effect of various increases in Federal income-tax rate

A. Taxable income, first 6 months 1951, annual basis: $14,533,000.
B. Additional gross revenues required to offset effect of increases in tax rates:

	Increase in tax rate From— (a)	Increase in tax rate To— (b)	Increase in Federal income tax (c)	Portion of additional gross revenues retained as not operating income (d)	Additional gross revenues required to offset effect of increase in taxes (e)=(c+d)
	Percent	*Percent*		*Percent*	
1	47	48	$145,000	50.29	$288,000
2	47	49	291,000	49.32	590,000
3	47	50	436,000	48.35	902,000
4	47	51	581,000	47.39	1,226,000
5	47	52	727,000	46.42	1,566,000
6	47	53	872,000	45.45	1,919,000
7	47	54	1,017,000	44.49	2,286,000
8	47	55	1,163,000	43.52	2,672,000

Senator BYRD. Mr. H. A. Schumacher.
Will you please identify yourself, Mr. Schumacher.

STATEMENT OF H. A. SCHUMACHER, VICE PRESIDENT, GRAFLEX, INC., ROCHESTER, N. Y.

Mr. SCHUMACHER. Mr. Chairman, I thank you for the privilege of appearing here.

My name is Howard A. Schumacher. I am vice president of Graflex, Inc., Rochester, N. Y.

I represent the National Association of Photographic Manufacturers, Inc., whose member companies produce more than 90 percent of the total volume of photographic products manufactured in the United States.

Permit me to summarize four vital points with respect to H. R. 4473. These points, together with other pertinent information, are more fully developed in our documented brief, which, with your permission, Mr. Chairman, I submit for inclusion in the record.

As you know, section 485 rewords the photographic excise section to accomplish three things:

First, it applies an increased rate of 20 percent on amateur films now taxed at 1 percent, and reduces the excessive 25-percent rate on presently taxed cameras to 20 percent.

Second, it substitutes clear, understandable language which eliminates present inequities and administrative difficulties, and

Third, it excludes those essential users who, it is our belief, were never intended to be taxed.

Let's examine these points more closely:

1. Excessive rates: Our industry's experience has proven that any mild business recession produces a very serious depression in such a heavily taxed area. You may remember our testimony of last year; in 1949 when general manufacturing employment fell off about 9 percent, the 25 percent taxed photographic equipment industry suffered a loss in employment of nearly 45 percent.

The tax bill passed by the House affords some correction of this high rate, namely, reducing it to 20 percent, although concurrently increasing the rate on taxed film from 15 to 20 percent.

Chart A which is in the material before each of you, shows that the photographic excises would then still be twice the rate of the other generally prevailing manufacturers' excises.

Then if revenue needs dictate the imposition of a 20-percent tax for the present, we will acquiesce in view of the fact that the technical rewording of the bill accomplishes other urgently needed changes.

2. Ambiguity. A damaging defect of the present photographic excise tax law is its ambiguous language. This defect is twofold:

First, the basis for determining which products fall within its scope is so intangible that it is impossible, even after 9 years, for the industry or the Government to determine a clear line between taxable and exempt products.

This has caused continuous administrative difficulty, rulings and reversal of rulings, confusion and inequity.

Secondly, the wording of the present law places photographic manufacturers in an unfair competitive situation in that it taxes many products at 25 percent if made by a photographic manufacturer even when sold for a nonphotographic use, but does not tax the same or similar articles when made by a nonphotographic manufacturer even when sold for photographic use. As a very portable example, I have here two print rollers. They are as alike as two peas in a pod—this one made by a photographic manufacturer, 25 percent tax; this one made by a nonphotographic manufacturer, tax-free.

Similarly, focusing cloths which you men may remember seeing before; here are two of them. One is taxed 25 percent, the other is tax-free.

What is the difference? One of them is hemmed.

Senator KERR. One of them is what?

Mr. SCHUMACHER. Hemmed; it has a hem sewed along the edge of it. The other one is unhemmed. The hemmed one is 25 percent; the other one is tax-free.

The provisions of the House bill will correct these two serious defects by substituting for the present law, language which by clean-cut definition limits the tax to those cameras, lenses, and films which were intended to be taxed.

Senator HOEY. Are you in favor of the tax bill as passed—this measure?

Mr. SCHUMACHER. Yes, sir, section 485.

Senator HOEY. You want the same thing?

Senator KERR. You are improving the language, but you are making a case against the amount of the tax?

Mr. SCHUMACHER. May I cover that for you in just a moment, sir? The third aspect of this revised bill relates to the business of Government cost items. When the wartime photographic excise taxes were imposed, it appears from the record that they were thought of as "luxury" taxes. The fact is that this tax is principally borne by users in such fields as industry, science, Government, medicine, education, training, publishing, law enforcement, and like essential activities.

About two-thirds of the sales of this industry are for such end use, as shown on chart B, which again, each of you men have.

The Ways and Means Committee in its bill has excluded from the base of the photographic tax the business cost items, stating that it believes that a tax on such photographic items is likely to be shifted forward as an operating expense and thus appear in the price of commodities generally.

Gentlemen, the present photographic excise tax stands alone as the one single manufacturers' excise which is imposed repetitively—time and time again throughout the production process.

This tax applies on both the major production equipment, and on the materials used to make a usable or salable product. As an example, let's look at a typical piece of printed material designed to do a high-priority job of disseminating important knowledge, including reproductions of photographs vital to the story.

Here is a copy of the handbook What You Should Know About the Atomic Bomb, an informative 55-page book issued by the Surgeon General, Army Medical Department.

It is illustrated with photographs including microphotographs; and some are not pretty—but they transmit vital medical knowledge visually, accurately. In the material before you is a condensed photo story of the taking of a picture and the conversion of that picture into a usable printing plate.

While the picture-taking camera shown in that illustration, which is identical to the ones the working press have here, is tax-free, because it is a professional instrument weighing more than 4 pounds, many of the items with which it must be used are taxed, as are the materials and equipment used at the several stages to produce a usable reproducible photograph, and finally, the printing plate itself. In all, believe it or not, the photographic excise tax under present law, is encountered a minimum of 84 times before just one of these illustrations can appear in this book—or in any textbook, scientific journal, magazine or newspaper.

What we show you is a repetititous cumulative tax-after-tax-after-tax, all of which become a part of the production costs of all such material. If published by industry, the tax becomes a cost of doing business and, therefore, is either pyramided in the selling price or taken as a direct reduction from corporate income and excess-profits taxes. If published by the Government, as in this instance, the tax becomes a cost of Government.

This brings out a further important consideration, namely, that the Government on its own substantial purchases of photographic products directly pays in normal times about 5 percent of the total collections. Presently, however, Government purchases for defense have been steadily mounting to the point where its direct payment of these taxes in fiscal 1951 amounted to approximately 10 percent of collections, with the rate still increasing.

Currently, the photographic industry has substantially increased its deliveries to defense industry where, of course, the taxes inflate rearmament cost.

We bring out the foregoing in view of the House report re H. R. 4473 which unanimously approves both the revised wording and revised tax base for the photographic industry, and the attendant indicated decrease of $23 million in revenue yield.

I say "indicated" decrease since a realistic conservative estimate of the prospective net loss in revenue to the Government is much less——

Senator BYRD. The suggestion you now make, how much will that increase that estimated loss of $23 million?

Mr. SCHUMACHER. We submit, sir, that the prospective net loss to the Government is nearer $6 million, and on page 19 of our brief——

Senator BYRD. What difference would it make? The proposal that you make to change the House provision, how much further loss would there be?

Mr. SCHUMACHER. Our proposal, as opposed to the House proposal?

We recommend the House proposal.

Senator BYRD. I know you do, but I say, don't you recommend something in addition to that?

Mr. SCHUMACHER. Yes, sir. We have one further recommendation.

Senator BYRD. What will that cost?

Mr. SCHUMACHER. Well, the additional recommendation, sir, deals with another section of the House bill, not with this section.

Senator BYRD. Are you satisfied with the House section?

Mr. SCHUMACHER. Of 485?

Senator BYRD. No. 12 on page 64.

Mr. SCHUMAKER. Section 485, that is a technical revision of the present law, and that, sir, will accomplish these beneficial changes in terms of affording equity to the industry.

Senator BYRD. Then you are also suggesting another change?

Mr. SCHUMAKER. One further change.

Senator BYRD. What is that one?

Mr. SCHUMAKER. On the basis of the foregoing, gentlemen, we submit that the revised wording of section 3406 (a) (4) as submitted to you by the House will do these things: It will restore reasonable equity to the photographic industry, which it has not had for 9 years.

It will assure us future job-making capacity, which was so obviously jeopardized in the little recession in 1949, and it will prove constructively deflationary as to the prices of the industry's products and services.

We commend it to you and respectfully request your support of it.

There is, however, one further problem with respect to the House bill which we believe you would wish us to bring to your attention. In section 484 the House would add certain household-type appliances to section 3406 (a) (3) of the Internal Revenue Code, which imposes a 10-percent manufacturers' excise tax on electric, gas, and oil appliances.

One of the items listed is "electric motion- or still-picture projectors" of the household type. We respectfully request that this item be eliminated from the final bill for the following reasons:

(1) Cameras and projectors are essentially complementary units and normally, for personal use, one is not purchased without the eventual purchase of the other. Under section 485 the user would be subjected to a 20-percent tax on the camera and again on each roll of film he buys.

If projectors were therefore to be taxed, under section 484 then the accumulative tax on the camera, plus film—plus projector would be much greater than that applicable to other competitive means of home entertainment.

Remember, these competitive products can be enjoyed without the repeated payments of tax which are involved in the use of a camera.

(2) The phraseology "electric motion- or still-picture projectors" of the household type is so indefinite that it certainly would create the same type of administrative problems and inequities which have plagued the industry under the present excise-tax law on photographic products.

Projectors, both still and motion picture, are vital keystones to visual education and training. They are used extensively in schools, colleges, industry, Government, the armed services, institutions, churches, and in farm groups and other organizations for the quick and accurate dissemination of information. Certain types of projectors are used entirely or principally for these important purposes and are seldom, if ever, used in the home.

In the light of these facts, we respectfully request and recommend that projectors not be subjected to a manufacturers' excise-tax. In the event that this request cannot be granted, we then urge the importance of developing a clear definition to be inserted at the appropriate point in section 484, to the end that the types of projectors which are entirely, principally, or importantly, used for essential purposes, be exempt from tax.

In behalf of the photographic industry as a whole, permit me to thank you for the opportunity to be heard and for the consideration we know you will afford our very unenviable present situation as to which major correction will be afforded by your approval of section 485 of H. R. 4473.

Thank you.

Senator BYRD. Thank you.

(The summary of information pertinent to the committee's consideration follows:)

[From the Sunday Star, August 27, 1950]

CAMERAS NOW AMONG WAR'S MOST LETHAL WEAPONS—INTERPRETATION OF PHOTOS BECOMES VITAL TO MILITARY

(By L. Edgar Prina)

"You can't win a war without pictures." That's the warning of Navy Capt. Robert S. Quackenbush, one of the Armed Forces' top photographers.

A former member of the staff of the Joint Chiefs and the founder of the first photographic interpretation school in the United States, the captain was convinced early that Gen. Werner von Fritsch, one time chief of the German general staff, was right when he said in 1938:

"The nation with the best photo interpretation will win the next war."

That goes for world war III, if and when it comes, Captain Quackenbush says.

America's military chiefs apparently agree. They are preparing a mass espionage effort to be ready for M-day. And they are relying upon three tools to do the job: Aircraft, cameras, and a highly specialized corps of photographic interpreters, scientific spies who extract intelligence from pictures of enemy holdings.

Should war come between this country and the Soviet Union, fleets of giant reconnaissance planes, including intercontinental B-36's and 650-mile-an-hour B-47's, would take off from bases all along the ring that encloses Russia. Sometimes they would precede the bombers, sometimes follow.

SUPERCAMERAS USED

From Alaska over the polar wastes; from Japan, Great Britain, France, Italy, the Middle East, and Africa they would swarm. Red coastal cities would come under the cameras of the jet aircraft from the decks of the Navy's fast carrier tasks forces.

Manned by expert crews, the planes would be loaded with the latest photographic equipment; cameras that click off pictures at the rate of 2,000 a second, television gear, facsimile machines to send pictures developed by the amazing Polaroid-Land process back to base in a matter of minutes, and radarscope recording cameras to pick out targets from unprecedented heights on the blackest of nights.

Available, too, would be 100-inch-lens cameras to snap targets as far as 25 miles away; triple-unit (tri-metrogon) machines to capture an image from horizon to horizon, and new color film to unmask the cleverest camouflage.

Working with the aerial force would be dozens of snorkel submarines popping their periscopes up through the ocean's surface to get additional pictures of enemy activity.

Military planners, of course, refuse to discuss target studies, but with the cold war waxing ever hotter, it is not difficult to guess whose cities are getting top attention. Obviously, our aerial warfare experts will want all the information they can get on the great industrial Moscow area, railroad hub of the U. S. S. R., and on Leningrad, with its shipyards, synthetic rubber, and diesel engine plants.

The oil fields, refineries and tank farms of Baku on the Caspian, greatest petroleum center in the Soviet Union, may rank high in priority, as well as the vast steel plants of Magnitogorsk. Sverdlovsk's machinery and machine tool factories are other points of great interest.

KEY ROLE OUTLINED

There are new cities in the U. S. S. R.—behind the Urals and deep in Siberia—that will become familiar overnight in the event of war. One is Stalinsk, in the rich Kuznetsk basin. It has big steel mills and a booming chemical industry. The others, Kandalaksha and Zvanska, are aluminum centers, key factors for the expanding Red Air Force.

Important too, are the uranium mines of the Sayan Mountains and the Chiatury manganese mines in Georgia. Irkutsk, with its aircraft engine and machine tool plants, and Saratov, with its vital ball-bearing factory, are other cities of increasing importance.

Captain Quackenbush, a solidly built man of 46, whose florid face is dominated by a slightly bashed in nose—a memento of his days as a member of a championship Annapolis boxing team—elaborated on his warning concerning photography's key role in war in an interview at the Pentagon.

"Before our forces can go anywhere they will need maps. And maps must come from pictures. The territory of our potential enemy is largely unfamiliar. We cannot depend upon existing charts and information," he asserted.

"Vital, too," he continued, "is bomb-damage assessment. It is the key to successful air operations. The only feasible method of accomplishing this accurately and quickly is by pictures. They will answer the two critical questions: Did the planes get through? What damage was inflicted?"

The Photographic Interpretation Center at the United States Naval Receiving Station, Washington, is the somewhat more pretentious successor to Captain Quackenbush's original school, which was established in a lean-to outside a hangar at the Naval Air Station, Anacostia, January 4, 1942.

Located in a massive quonset-type building whose ugly black frame sprouts a short rectangular wing, the PIC is the one military unit which has maintained a continuity of interpretation research since the war.

During the last 5 years it has concentrated on these tasks: Research and development in interpretation, photogrammetry (mapping) and terrain model building; training of personnel and operational jobs such as the study of some 10,000 top secret photographs taken at the Bikini atomic bomb tests.

When an officer student finishes the 40-week course at the center he is able to distinguish a ball-bearing plant from an atomic energy installation on a photo taken by a jet plane streaking at 600 miles an hour at 50,000 feet.

By studying pictures, interpreters (P-Eyes) can tell what an enemy has done, is doing, and is likely to do. They collect facts, analyze situations, and prepare reports from the caliber of a beach-defense gun to the over-all view of the enemy's economy and military potential.

Armed with a stereoscope for three-dimensional views, a magnifying glass, rules, scales, and proportional dividers, the student-officer hunches over his drawing board and works out the three elements of interpretation:

1. Plotting: The determination of exactly what area of enemy-occupied territory is covered by the photograph.
2. Identification, by consideration of sizes, shapes, patterns, shadow, tones, continuity, and tracks or lack of them.
3. Comparison with the last photos of the same area and existing maps.

BEST TYPES FOR JOB

Of great help are photographic "keys"—sample aerial-view pictures of every conceivable type of building, ship, terrain, installation, gun emplacement, etc. If the interpreter gets stuck, he compares the problem photo with the "keys."

PI is not a simple task. For instance, an interpreter, in noting coastal defenses of an enemy, is expected to determine among many other items, the number of guns, their types and locations, the sectors of fire and range, location and description of beach defenses, including fire trenches, barbed wire, exit barriers, tank traps, and pill boxes.

Wartime experience has shown that the best men for PI and photogrammetry are architects, geologists, city planners, industrial engineers, urban geographers, and forecasters—men with plan-view training. This was not an immediate discovery. In fact, lawyers at first were thought to be the best bets.

"But," explained Captain Quackenbush, who now commands the Naval Air Station at Key West, Fla., "we found they weren't so hot."

Almost every kind of technical man may be found on the PIC staff, or may be called in for his special skills when necessary.

The student is not overwhelmed with interpretation techniques. He is lectured by authorities on such subjects as guided missiles, strategic bombing, geopolitics, and atomic intelligence. He learns also how rubberized terrain models are made in the PIC's laboratory and ovens.

Selectivity of personnel and thoroughness of training are stressed because, as Captain Quackenbush is ready to concede, interpreters commit, as well as avert, blunders.

A wartime case in point involved the invasion of Hollandia. Interpreters mistook a silted river bed—a morass of fetid, oozing earth—for a broad road which would provide easy and rapid exit for the assault troops. The result was that the men had to be reembarked and landed on another beach many miles away. Fortunately there was no enemy opposition, and the withdrawal was successful.

The PIC is making great strides in research and development, thanks to its staff of experts and its liaison with university groups, the Naval Research Laboratory, and other military-scientific organizations.

Improvements of television photography for military use is one of its top postwar projects. Progress has been so great that pictures are almost as good as those taken by a conventional camera.

TV has been successfully employed on two operations—Bikini and Antarctica—and, according to Captain Quackenbush, its potentialities are almost unlimited. The captain envisions ground or carrier-control robot planes, whose television cameras can record the scene below and send it back to receiving screens at headquarters. There, conventional photographs may be taken for more leisurely and detailed study. Television-equipped rockets also may be close at hand, he believes.

Another high-priority project is the development of radarscope and instrumentation photography and interpretation. Cameras, of course, have limitations. One is that they can't pierce cloud banks to get pictures. The Navy refused to bow to the whims of nature and plunged into radar photography.

Development of infrared and color photography for night work and anticamouflage jobs is being pressed. Also, it is possible with color film to study a factory's waste products and thereby identify the plant.

Great advances are being made in precision mountings and stabilization of cameras in aircraft. Some planes—like the RB-36, the supersnooper, with a range of more than 10,000 miles, will carry a dozen or more cameras, all controlled at a master switchboard. A simple flick of the finger will swing the lenses to the desired angle and take the pictures.

MOST WORK SECRET

As for PIC's postwar operational work, most of it is secret. A great deal involved its role in Operations Crossroads at Bikini. Also several PIC men accompanied Admiral Byrd to the South Pole for Operation Highjump. They helped in permafrost research and in studies to determine how thick the ice must be to hold certain weight planes, etc. Scores of pictures were sent 10,000 miles back to Washington in a matter of a few minutes via the magic of facsimile.

Photographic interpreters were on the staffs of the contending forces in almost all postwar training maneuvers and are now proving their indispensability to adequate intelligence on the fighting fronts of Korea.

The newly matured science has come a long way since Captain Quackenbush and his naval school staff grappled with their first problem print more than 8 years ago. The impact of PI on the military mind during the recent war, although not immediate, was great.

Success of P-Eyes in plotting underwater obstacles and beach gradients at Normandy and Okinawa, in discovering the first operational German jets and the V-1 and V-2 rocket-launching sites and testing grounds, won over a lot of skeptical and critical commanders. Photographic interpretation's role in future warfare is assured, and it will be a big one.

NATIONAL ASSOCIATION OF PHOTOGRAPHIC MANUFACTURERS, INC.,

New York, N. Y., August 1, 1951.

In the matter of the manufacturers' excise taxes on photographic apparatus (sec. 3406 (a) (4)) and on electric appliances (sec. 3406 (a) (3))—sections 485 and 484, respectively, of H. R. 4473.

COMMITTEE ON FINANCE,
United States Senate, Washington, D. C.

GENTLEMEN: This association, whose member companies, according to the best available information, produce more than 90 percent of the total volume of photographic products of all kinds and types manufactured in the United States, respectfully presents information concerning the extremely harmful and repressive effects of the present excise-tax law applicable to photographic products, and in support of the provisions of section 485 of H. R. 4473 as approved and reported by the Committee on Ways and Means and passed by the House of Representatives.

In its report, that committee points out that section 485 of its "bill makes two changes" in section 3406 (a) (4), the photographic excises, namely:

(1) "A uniform 20-percent rate is substituted for the 25-percent tax on photographic apparatus and the 15-percent tax on film.

(2) "Second, the bases of these taxes are revised so that the tax is imposed only on film, cameras, and lenses which, insofar as is administratively possible, do not represent a cost of doing business."

Also, in section 484 of the bill, in adding new products to section 3406 (a) (3), under electric appliances, "household" type, projectors have been included.

The following material undertakes to provide pertinent information as to the importance of and necessity for the changes provided in section 485 and the undesirability of the particular change in section 484.

I. FACTS ABOUT THE PHOTOGRAPHIC INDUSTRY

The following information about the photographic industry, its products and their applications, may be of interest to the committee:

1. Nature of the industry

The photographic manufacturing industry is relatively small. Because of the very highly specialized nature of its products and their exceptional essentiality in wartime it is one of the key strategic industries.

Most of the companies in the industry are small, but their continued success is of the greatest importance to the strength of the industry and to its ability to serve in both peacetime and wartime.

There are, according to the best information available to us, about 150 companies in the United States engaged wholly or importantly in the manufacture of photographic products, or which, though not principally so engaged nevertheless produce in significant volume one or more photographic products. The 1947 Census of Manufacturers records 366 establishments with a then total of 50,911 employees and a total value of products shipped of $440,184,000.

Photographic manufacturing plants are principally located in these States: California, Connecticut, Delaware, Illinois, Indiana, Iowa, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New York, Ohio, Pennsylvania, Wisconsin, with scattered plants in some other States.

There are thousands of establishments in other branches of the photographic industry, namely, photographic distributors, photographic retailers, photofinishers, commercial, industrial, and professional photographers, and such related industries as photoengraving, photolithography, and others. These other branches of the photographic industry and related customer industries provide gainful employment to thousands of persons in every State in the Union.

2. Nature of products and applications

This industry is principally engaged in the manufacture of photographic products which, in dollar volume and in application, are preponderantly (nearly two-thirds) for commercial, industrial, educational, scientific, professional, governmental, and similar uses. A brief, illustrative listing of some of these uses is provided on page 203 of the Senate hearings on H. R. 8920, Eighty-first Congress.

It should not be overlooked, however, that sales to amateur photographers are also very important to this industry and its continued success. In fact, certain plants which are key precision plants in wartime depend substantially upon this market for their peacetime operation and, therefore, for their availability to serve in wartime. In this connection it should be emphasized that these precision photographic manufacturers with their highly skilled and specialized personnel and machinery are a major national asset which cannot be expanded rapidly to meet a national emergency.

3. Industry of key strategic importance

It cannot be too strongly emphasized that the photographic manufacturing industry is one of the Nation's most essential key strategic industries. Its photographic products in tremendous volume are absolutely essential to successful military operations in modern warfare before, during, and after combat, for essential industrial uses in the production of other war material, and for many essential noncombat military needs. A brief listing of some of these key uses is provided on pages 203–205 of the previous Senate hearings.

As just one example of defense industry use of photographic methods in development, production, inspection, testing, plant protection, and a myriad of uses, it might be well to recall that it was photographic methods that broke the production bottleneck in the aircraft industry and made and still do make large production goals attainable both in quantity of planes and in speed of getting newly developed planes into the air.

Most photographic products can be made during wartime only by the photographic industry because of the highly specialized skills and facilities required for their manufacture. It is to be remembered that most wartime photographic products are the same as or are modifications of regular peacetime photographic products.

An example of the conversion of a regular peacetime product to an essential wartime product is the gun-sight aiming point camera required in every combat aircraft. The gun-sight camera was produced in volume during the war by manufacturers of high-precision civilian 16-millimeter motion-picture cameras and are a simple modification thereof. It uses the same film magazine as the civilian camera. Obviously only peacetime production of these civilian cameras and magazines assures wartime availability of this military camera.

As another example, take a 500-foot roll of film for aerial photography. This film is made by the same employees and on the same basic equipment as civilian roll film. You can visualize why the military uses so much film since a single aerial roll contains enough film to make up to 5,000 rolls of the civilian types, yet it would be used up in a few minutes in photo reconnaissance work.

In addition to the foregoing, because of the peacetime-developed skills of its employees, the photographic industry was also called upon during World War II to produce large quantities of high-precision, complex war equipment of a nonphotographic nature.

A War Munitions Board report (March 1948) stated that during World War II 72 percent of the products of the photographic industry went to essential military claimants. Half of these products for military uses were regular photographic products. The remaining 28 percent of the industry's wartime production went to nonmilitary claimants. This included materials for use by war industries in military production, by scientific laboratories, by local government units, and by civilians.

A vigorous peacetime photographic industry is essential to national security. There is no substitute for its military products.

II. GENERAL COMMENTS AS TO TAX

Since October 1, 1941, the photographic manufacturing industry, its sales outlets, its customer industries and other product users, have been handicapped seriously by an inequitable, discriminatory, unclear, and unduly burdensome excise-tax law. At that time, in the Revenue Act of 1941, 10 percent manufacturers' excise taxes were applied to various products including photographic equipment and sensitized goods.

Then in the Revenue Act of 1942 photographic excises were singled out for heavy increases, while such taxes on other manufactured products were either eliminated (7 instances) or maintained at 1941 levels (19 instances). As a result, since November 1, 1942, this industry and those it serves have been burdened with excessively high excise rates—25 percent on equipment, machinery, and apparatus, and 15 percent on sensitized materials, films, papers, and plates.

In the Eightieth Congress, we appeared before the Ways and Means Committee and submitted evidence in support of our contention that these high rates of taxes had already caused some injury to the industry. Our greatest concern, however, was that the conditions complained of would become progressively worse unless the requested relief was promptly provided. We also pointed out that these high rates of tax would greatly accentuate the effect on this industry of any period of recession such as, in our opinion, we could then foresee.

In a unanimous report that committee, after extensive hearings on excises, recommended to the House of Representatives the passage of bill H. R. 4259, stating that the amendments to the photographic excise tax law provided therein would relieve one of the most acute excise tax hardship cases that had come to its attention. Although the bill was passed by the House, it did not come up for vote in the Senate. This industry therefore, remained in the unenviable position of being subjected, in a wide product area, to special discrimination and inequity.

In the Eighty-first Congress, we again appeared before the Ways and Means Committee, and before your committee, this time to show how our actual experience had far-exceeded our previously expressed fears of serious injury, especially in the 25-percent-taxed areas. In particular, our evidence (see pp. 268–276, Hearings Before the Committee on Finance, 81st Cong., on H. R. 8920) showed:

(1) That what was a mild recession (1949) for manufacturing industries in general, which suffered a loss in employment of about 9 percent, was a deep depression for the photographic manufacturing industry. The 25-percent-taxed area suffered a 45 percent loss in employment and sales.

(2) That losses were much greater than would be expected as judged against the experience of this industry in previous periods of recession, according to informed industry opinion.

(3) That a number of small- and medium-size concerns largely or wholly dependent upon photographic markets had either failed or were in severe financial difficulties with the ultimate outcome in doubt.

(4) That a composite tax and profit and loss statement (provided confidentially to the committee) showed as to companies whose products are principally or wholly subject to the 25-percent rate of tax that these companies as a group had gone from a satisfactory profit position to a loss position. These data indicated also, from the 25-percent-taxed area, that there was a drop in payments to the Federal Government, 1949, as compared with 1948, in Federal corporate income, withholding, old-age benefit, and photographic excise taxes, of more than $16 million. This probably equaled, and thus might be thought of as having canceled out, the total excise collections at that rate.

(5) That purchases of photographic equipment both for new plant and for expansion or replacement in important customer industries (especially the graphic arts industries) had been and were continuing to be discouraged by the large amounts of tax involved.

(6) That entry into industries or occupations requiring photographic equipment had been made very difficult especially because of the taxing of livelihood tools and production equipment at 25 percent.

As just one example, you will recall the complaints as to the 25-percent tax which you received from veterans seeking to establish or to reestablish themselves in one of the industries or occupations requiring photographic equipment. On the typical capital equipment required to set up a very modest establishment, an excise tax of $2,000 or more is involved. This, they pointed out, is almost prohibitive and constitutes a terrific syphoning off of their limited capital.

(7) That the losses already experienced had clearly endangered the ability of this industry to serve with full effectiveness in the event of a national emergency.

This condition, as a result of the Korean situation, has since been temporarily relieved by a combination of scare buying—which has long since disappeared—and by expansion of the defense preparations with resultant important increases in the requirements of the Government and of defense industries for photographic products. However, the repressive effects of the present law and its excessive rates are still clearly taking their toll.

Although in the Eighty-first Congress the Ways and Means Committee again strongly recommended and the House of Representatives in H. R. 8920 passed a correction of the photographic excise-tax law, your committee was forced by circumstances to greatly alter the House bill. As one result, greatly needed changes in the photographic excise-tax law were again postponed.

Now, in the present Congress we have once more called to the attention of the Ways and Means Committee and we now call to your attention the need for corrections in the photographic excise-tax law. The House of Representatives has again approved the major technical revision which, except for the 20-percent rate, is the same as that contained in H. R. 8920 of the last Congress on which we appeared before your committee last year.

The following material discusses the pertinent provisions of the House bill, provides additional factual material with respect to them and respectfully requests favorable action on the part of your committee and the Senate.

III. SECTION 485, H. R. 4473

Section 485 of H. R. 4473, as stated in the report of the Ways and Means Committee makes two major changes in the present manufacturers' excise on photographic products (sec. 3406 (a) (4) I. R. C.) the second of which is greatly needed and much overdue, namely:

(1) "A uniform 20-percent rate is substituted for the 25-percent tax on photographic apparatus and the 15-percent tax on film.

(2) "The bases of these taxes are revised so that the tax is imposed only on film, cameras, and lenses which, insofar as is administratively possible, do not represent a cost of doing business."

The present photographic excise-tax law has two very serious defects, (1) poor phraseology and (2) excessive rates. To discuss these in reference to section 485 of H. R. 4473:

1. Phraseology is discriminatory and unclear in present law

Your attention is again called to the real need for the technical revision of the present law which is provided in section 485 of the House bill. The phraseology of the present law (sec. 3406 (a) (4) I. R. C.) makes inequity, discriminatory application and uncertainty inevitable.

In the first place, it undertakes to tax "photographic apparatus and equipment and any apparatus or equipment designed especially for use in the taking of photographs or motion pictures, or in developing, printing, or enlarging photographs or motion pictures," but fails to provide any definite or adequate basis for determining which articles may be classified as photographic. In fact, the factors which the law offers for determining which products fall within its scope are so intangible, that it is impossible, even at this late date, for the industry or the Government to determine a clear line between taxable and exempt products.

Hundreds of rulings have been issued by the Bureau of Internal Revenue with respect to the application of the photographic excise tax to specific products. However, numerous articles remain in a doubtful position with respect to the tax and many serious inequities remain.

In the second place, and even more importantly, in many product areas, the application of the tax has placed the photographic manufacturer in a most inequitable competitive position. In fact, a major reason given by the Committee on Ways and Means for the amendments made by section 485 is to correct this serious situation, the report pointing out that—

"* * * difficulty has arisen in the case of the tax on photographic equipment, because apparatus made by photographic manufacturers frequently has been held to be designed especially for photographic use, even when sold for nonphotographic purposes. Similar equipment sold by nonphotographic manufacturers has been held not to be subject to the photographic tax because it was not designed especially for photographic use. As a result manufacturers of photographic equipment have frequently been placed at a competitive disadvantage."

This serious and most inequitable competitive situation is inherent in the phraseology of the present law. Except for a few products that are basically photographic, such as cameras and sensitized materials, the items taxed under the photographic excise tax law are not unique to the photographic field but are used extensively in other occupations and trades.

For example, products such as tripods, trays, rollers, tanks, sinks, timers, squeegees, and lighting equipment are widely marketed for nonphotographic purposes. When such items are sold by the nonphotographic manufacturers they are free from tax, even though they may be sold for photographic use, but when sold by the acknowledged manufacturer of photographic products they are subject to the 25 percent excise tax even though sold for a nonphotographic use.

The acknowledged manufacturer of photographic products is, therefore, placed at a tremendous, if not impossible, competitive disadvantage when he must try to sell his products, taxed at 25 percent, in photographic or nonphotographic fields against the competition of untaxed products of a like nature marketed by the nonphotographic manufacturer in these same fields of use.

This grossly unjust competitive situation and the uncertainty of the present law would both be corrected by section 485 of H. R. 4473. It would substitute clear, precise language which would be easy to understand and apply and which we believe would eliminate the present administrative difficulties. In fact, the only solution to this serious problem is through amendment of the present law.

2. Business cost items

In the rewording of the law provided in section 485, the Committee on Ways and Means stated that one of the reasons why it has excluded business-cost items from the photographic excise-tax base was because taxes on these items are likely to be shifted forward as an operating expense and thus appear in the price of commodities in general. This is indeed particularly and peculiarly true as to the photographic excises.

Some of the principal considerations are:

(1) The applications of photography are very widespread. It is no overstatement to say that the photographic industry today affects the life of every person in the Nation. It is vital to the country's safety, progress, and welfare. It is important to the Nation's economy. A listing of some of the important uses of photography in industry, in the community, in Government and in other highly essential needs, both peacetime and wartime, has already been provided to you. (See pp. 263–266, Revenue Revisions of 1950 Hearings before the Committee on Finance.)

(2) Nearly two-thirds of the sales of this industry are for commercial, industrial, educational, training, publishing, medical, governmental, scientific, and similar essential uses. (See exhibit B.)

(3) Over 60 percent of the collections of the photographic excises represent cost of operations to the taxpayer and are so reflected in the income-tax returns of thousands of businesses throughout the country.

(4) An especially undesirable aspect of these excises as a business cost is the fact that they apply to livelihood tools, production equipment and materials, and operating supplies used by many thousands of establishments throughout the country.

(5) One of the peculiarities of the photographic excise-tax law which, insofar as we know, is not true of any other excise tax is the fact that it taxes both the equipment on which a salable product is made and the materials from which the product is made. Thus, whether for business or personal use, users feel the repeated impact of photographic excises.

With most excise-taxed products, once the product is purchased and the excise is paid its use can then be enjoyed without payment of further excises. Not so with the photographic excises. First, the camera and other equipment and accessories involved in taking the picture is taxed. Then the camera must be supplied with film or plates which are taxed. Then the film or plates must be processed in equipment that is taxed; then, if prints are involved, they must be made on paper or film which is taxed. Then, in turn, these must be processed in equipment which is taxed.

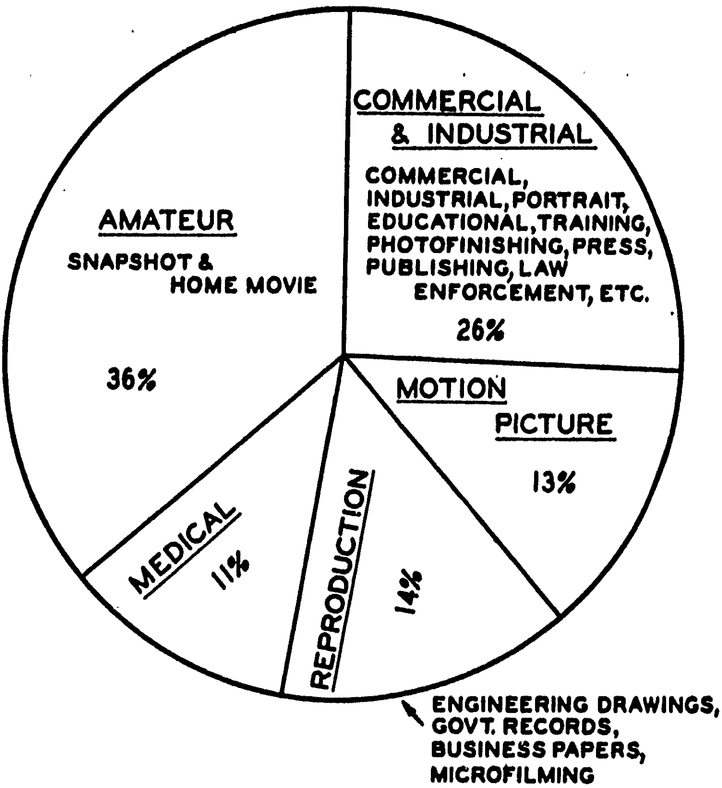
As brought out in our testimony, just as one example, the photographic excises are encountered a minimum of 34 times in the preparation of a photographic illustration such as would be used in a textbook, journal, magazine, catalog, newspaper, or other publication.

This necessity of providing other taxed equipment and constantly providing taxed supplies in order to make use of the original taxed product thus places

PHOTOGRAPHIC PRODUCTS

DISTRIBUTION BY CONSUMER USE IN U.S.

1950 ESTIMATE



NATIONAL ASSOCIATION of PHOTOGRAPHIC MANUFACTURERS, INC.

a further inequitable and discriminatory burden on this industry and its millions of customers. This, plus the high rates, serves to emphasize and explain the special sales-deterrent characteristics of the photographic excises, and also why these taxes tend to pyramid in business costs.

3. Government cost items

Business-cost items might well also have been labeled "Government cost items," since te Federal Government itself is without doubt by far the largest payer of the photographic excises. The provisions of section 485 will thus serve to save the Government several million dollars a year in its direct payments of these taxes on its now substantial purchases of photographic products.

Government purchases of photographic products for defense needs have been steadily mounting. At the same time, as might be expected, the demands of defense industries for photographic products have similarly increased, the photographic excises thus serving to increase defense costs.

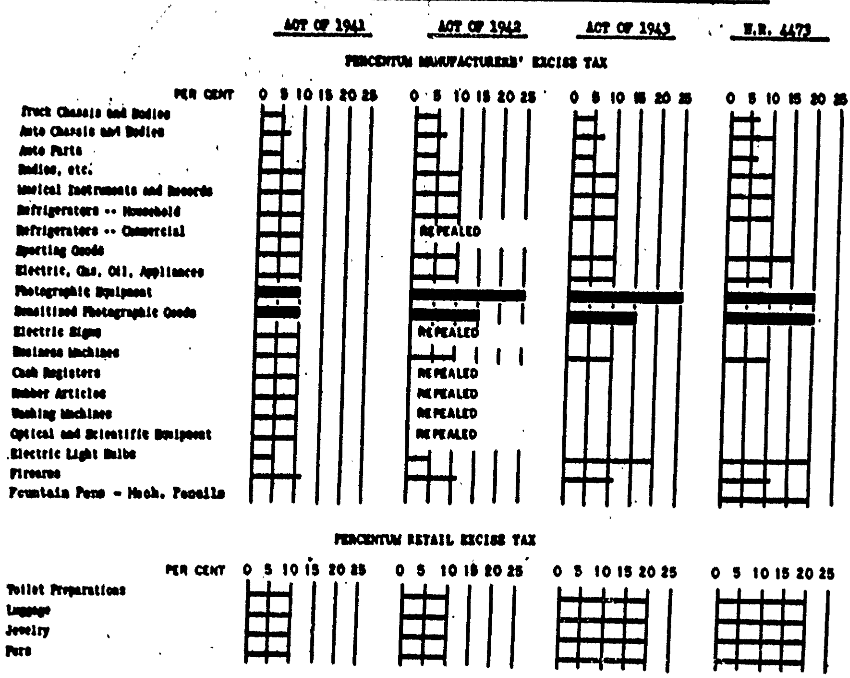
As we have pointed out, no one knows just how much the photographic excises represent an added cost to the Government because of their inclusion and pyramiding in defense product costs. However, even under present conditions, it must be a very substantial sum and may easily exceed the amount of this tax which the Government pays directly.

Section 485 of the House bill will eliminate, almost 100 percent, the photographic excises paid directly or indirectly by the Government.

4. Present rates regressive and discriminatory

The present rates of photographic excises, namely, 25 percent on apparatus, machinery, and equipment, and 15 percent on sensitized papers, plates, and film—are clearly excessive. As brought out in the bar chart, herewith, these rates are much higher than the generally prevailing 10-percent rate of manufacturers' excises.

EXCISE TAXES PENALIZE PHOTOGRAPHIC INDUSTRY IN RELATION TO OTHER INDUSTRIES



SPECIFIC MANUFACTURERS' EXCISE TAX

Tires	$.05 per lb.	No Change	No Change	No Change
Tubes	$.09 per lb.	No Change	No Change	No Change
Matches -- Plain	$.02 per 1,000	No Change	No Change	No Change
Matches -- Fancy Wood	$.055 per 1,000	No Change	No Change	No Change

NOTE: In the case of several of the above tax classifications, there have been changes in coverage by either adding or excluding certain items, the details of which are set forth in the Report accompanying H.R. 4473.

As we have previously reminded the committee, (1) the present high rates were the first of the penalty, regulatory wartime excises intended to reduce consumer demand and assure adequate supplies for the Armed Forces and (2) photographic products were alone singled out to bear these excessive rates.

You are also aware of the fact that from the time they were imposed these rates helped in part to force involuntary conversion of the industry to nonphotographic products and that the resulting lack of ability to obtain photographic products in their required quantities was one of the most serious situations faced by the armed services in the early part of World War II.

The high rates, in addition to their regressive effect on sales and employment in this, a key defense industry, also have served to intensify the extent of injury arising from the other bad characteristics of the photographic excises. The 25-percent rate in particular, as we have demonstrated, has been so harmful as, we believe, must clearly brand it as an unwise and unprofitable tax.

These taxes principally add to the cost of science, research, education, government, business, and other essential activities. They are unduly burdensome and inequitable.

For this industry, they have turned what for industry in general was a mild recession into a deep depression, and, if retained, will evidently do so again. In fact, it appears that currently they may have started to do so again.

These high rates often result in very large dollar amounts of tax per unit. It is not uncommon for a piece of equipment to involve an excise tax of from $1,000 to $10,000. Since this for the most part is production equipment, these taxes therefore constitute a substantial drain on working capital and operating funds and curtail employment opportunities not only in the photographic manufacturing industry but in the many industries which use photographic methods and processes.

The provisions of H. R. 4473 would reduce the 25-percent tax on equipment to 20 percent, but in doing so would increase the 15-percent tax on film to 20 percent. While pointing out that the proposed 20-percent rate is still double that of most manufacturers' excises, nevertheless the important corrections in the base which have been adopted by the House represent such meritorious and urgently needed improvements in the present law that, in view of present circumstances, we merely call this fact to the attention of the committee.

5. Microfilm

One of the important business-cost items which the House bill is designed to eliminate from the tax base is microfilm. This is widely used by banks, insurance companies, railroads, libraries, medical institutions, retailing establishments, and business generally. It has numerous important applications in Government. Today it is even possible to subscribe for such publications as the Federal Register and many important daily newspapers in microfilm form.

Microfilming provides an exceptional means for the preservation of records and for most extraordinary conservation of storage space. One example given of space saving shows a huge pile of 28,000 blueprints, weighing nearly 8,800 pounds. These were reduced to 92 rolls of microfilm weighing a total of 52 pounds.

Beginning especially with the last war, many concerns have made extra prints of microfilms of important records, drawings, formulas, contracts, and other essential documents and information, and have stored these at some safe distant point. In fact, the Government has again been emphasizing the importance of this means of safeguarding essential information against loss through destruction of the originals which might otherwise have crippling effects.

In Section 485 of H. R. 4473 the exclusion of microfilm from the tax base is accomplished in general by the fact that microfilm exceeds the length limitation of taxable film as set forth in the bill. It has come to our attention, however, that microfilm in the form required for use in certain microfilm equipment of two of the manufacturers does not exceed such length limitations and therefore, entirely through oversight, would be subject to the tax which is intended to apply to amateur roll film only. While this is a very minor defect in section 485, it is evident that it would place these two manufacturers at a substantial competitive disadvantage and that it would continue to tax in part a business-cost item in which it was intended to eliminate completely from the tax base.

This inadvertent defect could be corrected by adding the words "to unperforated microfilm," immediately following the words "X-ray film," in line 1, page 140, of H. R. 4473, making the portion read:

"* * * The tax imposed under this paragraph shall not apply to * * * X-ray film, *to unperforated microfilm*, to film more than one hundred and fifty feet in length, or to film more than twenty-five feet in length and thirty millimeters in width. Any person who acquires unexposed photographic film not subject to tax under this paragraph and sells such unexposed film in form and dimensions subject to tax hereunder (or in connection with a sale cuts such film to form and dimensions subject to tax hereunder) shall for the purposes of this subsection be considered the manufacturer of the film so sold by him."

The reason for using the word "unperforated" is to avoid any possibility of tax-free sales of perforated 16-millimeter amateur-type motion-picture film under the name "microfilm." Amateur motion-picture cameras will not accept unperforated film nor would it be possible or feasible or economical for any person to undertake to perforate or have such film perforated for his use as a means of seeking to avoid tax. It will be noted that, in the language of section 485, once the film in question is perforated it would become subject to tax.

By way of further comment, it might be stated that film intended for microfilming use differs greatly both in contrast and in emulsion speed from that which would be used for motion-picture work. In fact, the contrast would be much too great and the speed of emulsion much too slow to make such film usable for purposes of motion pictures. As evidence of this fact, it will be noted that the film ratings for speed of emulsion as provided by the American Standards Association for the various types of black-and-white motion-picture film run from 10 to 100, while those applicable to microfilm run from 2 to 8.

From the standpoint of contrast, the emulsion of microfilm is so prepared as to accentuate blacks and whites; in other words, to produce a sharp, high-contrast black and white result. Film suitable for use in motion-picture cameras is exactly the opposite; namely, the emulsion is designed to pick up with the greatest possible refinement all of the minor gradations of gray which run between white and black. Furthermore, insofar as attempting to use microfilm for motion pictures is concerned, the film when exposed and developed would result in a negative. It would then be necessary to go to the added expense of obtaining a positive print for projection purposes. The amateur avoids this expense by using a special reversal-type film in his camera which is returned to him after processing as a positive ready for projection. The use of microfilm for ordinary photographic purposes thus would be too costly as well as entirely unsatisfactory and unacceptable.

Accordingly, since it appears that the correction as above suggested is fully in harmony with the intent of the House, and therefore in no way affects expected revenue from the revision of section 3406 (a) (4), which is provided in section 485 of the House bill, and since it corrects a most undesirable competitive inequity which would otherwise result, we respectfully request the committee to adopt this correction.

6. Loss of revenue would be slight

The gross collections of the photographic excises are misleading in that they furnish no reliable indication of actual revenue. The net revenue is in fact much less than collection figures would indicate.

Turning to the matter of the net loss of revenue to the Government which would result from the enactment of section 485, H. R. 4473, we estimate this will be only about $6 million. This estimate, as you will note from the details below, is on a very conservative basis. For example, it makes no allowance for the effect of any of the improvements in sales in the photographic industry which we believe would be certain to result.

This $6 million estimated net loss of revenue contrasts sharply with the $23 million gross loss of revenue indicated in the House report. Even though the Ways and Means Committee and the House were willing to approve this $23 million loss of revenue, may we suggest that it is the indicated $6 million net loss of revenue which should be kept in mind.

For example, of the $44 to $48 million indicated collections (fiscal 1952) from this tax, our data indicate that the Government will directly pay $5 million—$6 million and indirectly, as an added cost of defense production, may pay at least as much more. Why should these substantial sums, paid out by the Government with one hand and then in time received with the other hand, be considered as revenue, or why should the elimination of these tax transactions with their attendant costs be considered a loss of revenue, in any realistic sense?

Then, to, about 60 percent of the present collections of these taxes are a cost-of-operation item. Under section 485 the tax would be removed from these items. Accordingly, a reduction should be made in the $23 million estimated loss to recognize the fact that the photographic excises will be almost 100 percent eliminated as a deduction from income in determining taxes based on income.

Photographic excises, as mentioned above, which are a part of defense production costs, together with any pyramiding which may occur, become a cost to the Government. However, we have here taken these into consideration only in our business-cost calculation (see item 2 in table below) where only 50 percent of the total amount of tax is taken into account. Accordingly, this means that our estimated net revenue reduction of $6 million is too high. Further, if defense-production levels increase, there will be a further increase in tax cost to the Government and, therefore, this estimated net tax loss would be further cut and could even be eliminated.

The details of our estimate are as follows:

Estimate of net revenue reduction under sec. 485, H. R. 473

[Millions of dollars]

1. Estimated gross yield for fiscal year 1952 under the present law (sec. 3406) (a) (4) I. R. C.)	48.0
2. Of this amount, at least $23.8[1] would become a business cost. If the average normal- and excess-profits-tax rate were only 50 percent, the net return to the Treasury with respect to this portion of gross collections would be reduced by about	11.9
3. Of the $48 million gross yield, the Government itself would pay on its direct purchases photographic excise tax of between $5 to $6 million	5.0
4. If there is deducted from the indicated gross revenue, the sum of these two amounts, or	16.9
5. It is clear that instead of $48 million, the maximum net revenue for fiscal year 1952 under the present law would be	31.1
6. Whereas the estimated revenue under sec. 485 of the proposed law would be	25.0
7. Giving an estimated net revenue reduction under sec. 485, H. R. 4473, of only	6.1

[1] 60 percent of $48 million, or $28.8 million, less $5 million of Government self-payments, resulting in $23.8 million.

IV. SECTION 484, H. R. 4473

The Ways and Means Committee, in expanding the coverage of section 3406 (a) (3), I. R. C. (sec. 484, H. R. 4473), electric, gas, and oil appliances, has added, under the heading "Appliances of the household type," an item "Electric motion or still picture projectors." This was not under consideration at the time and therefore not a subject of hearing before the Ways and Means Committee.

May we therefore call to your attention the uncertainties and inequities in this proposal.

1. Importance of projectors

To begin with, projectors, both still and motion picture, are the most important single tool in visual education and training. As such, they are used very extensively in schools, colleges, industry, government, and by the armed services, churches, libraries, hospitals, and other institutions, by communities and farm groups and similar organizations. The accompanying page lists a few of the important uses of projected pictures.

Projected pictures provide for the quick and accurate dissemination of information and greatly accelerate and intensify the learning process. In fact, tests by the armed services have established that through visual means approximately 35 percent more is learned in a given time and the information learned is remembered up to 55 percent longer. As might be expected, therefore, the requirements of the services for such equipment are very great and their applications are both numerous and important. We are told that every member of every branch of the Armed Forces receives training by means of projected pictures.

Certain types of projectors are used entirely or principally for the important purposes outlined briefly above and are seldom, if ever, used in the home. A study recently made by the National Audio Visual Association for the United States Office of Education indicates that 93 percent of the sales of such projectors as 16 mm. sound projectors, film-strip projectors, sound-slide projectors, time-study projectors, X-ray projectors, overhead projectors, opaque projectors, and microscopic projectors go to these essential users.

2. Involves problem of definition

As to the present proposal, first of all, the description "electric motion- or still-picture projectors of the household type" is of such an indefinite and indecisive nature that to retain this designation would be certain to result in the same type of administrative problems and difficulties which have been so persistently troublesome with respect to the present excise-tax law on photographic products.

It should be noted that in general there is nothing inherent in a still- or motion-picture projector which limits its use to the home as contrasted with some other location, uses, or vice versa. As might be expected, there are some projectors which may be thought of as "household type" which, nevertheless, are employed importantly in essential uses. This is especially true as to instructional uses by schools and churches where substantial use is made of some of the same types of projectors which are also generally purchased for home use. In this connection, the committee is aware of the fact that tax-supported schools at the expense of some paper work and delay can purchase excise-taxed equipment tax-free through the use of tax-exemption certificates. However, churches and the numerous private and parochial schools and universities which are not tax supported cannot do so, but must pay the excise taxes applicable to their purchases.

It will also be noted that the various types of projectors are each designed to serve a projection need. They will be used, therefore, where the particular need exists, thus:

Projected pictures are working tools for—

Industrial plants
Banks
Granges
Farm bureaus
Service stations
Hospitals
Medical schools
Research centers
Adult educational groups
Graduate professional schools
Colleges
High schools
Junior high schools
Vocational and trade schools
Elementary schools
Consolidated schools
Church groups
Fraternal groups
Civic groups
Veterans groups
Community groups
YMCA
YWCA
YMHA
YWHA
Boy Scouts
Girl Scouts
Signal Corps
Army Pictorial Service
Information and Education Division
Army Service Forces training centers
Army engineers
Infantry battalions
Armored divisions
Tank destroyers
Campfire Girls
4-H groups
Health agencies
Social agencies
Government agencies
Gunnery officers' ordnance school
Fire control school
Gunner's mates school
Electric hydraulic school
Optical school
Instructor training schools
Marines
Coast Guard
Aviation service schools
Naval air stations
Bureau of aeronautics
Instrument flight training
Medical Corps
Army Air Forces
Army Service and Ground Forces and special arms
Quartermaster Corps
Coast Artillery

Wherever GI's train, fight, and rest.

The ceiling projector is one of many examples of a projector which may be used in the home or elsewhere—in this case in the hospital or wherever a helpless person may be. Its purpose is to project the pages of a book onto the ceiling so that a bedridden person, otherwise unable to read, may be able to do so, requiring no more assistance than that of having the projector set up for him, since he can then operate it. This type of projector is being used importantly in veterans' hospitals and is a project frequently sponsored by a local service club. It would be highly undesirable that such a projector be made subject to tax.

We believe, for reasons which are evident in the above discussion and for further reasons which will now be brought out, that projectors should not be made subject to a manufacturers excise tax. However, in the event that this request cannot be granted we then call attention to the importance of developing a clear definition of taxable projectors, this to be inserted at the appropriate point in section 484. We would further respectfully urge that instructions be given that this definition shall be so prepared that the types of projectors which are entirely, principally, or even importantly used for essential purposes shall not be made subject to tax.

2. Would be inequitable and burdensome

A second important consideration in connection with this proposed tax is the matter of equity, namely, that it would place a further tax on an already overtaxed area, and would place the products involved at a competitive disadvantage.

Cameras and projectors are complementary units. Normally, for personal use, a projector is not purchased except with or following the purchase of a camera. If the projector is taxed, the total cost of the necessary equipment will be importantly increased. This will place photographic products at a further competitive disadvantage with other home entertainment products with which they compete for the consumers' dollar. These other products either are not taxed or are taxed at half the rate which would be applicable to the taxed cameras and film. Furthermore, unlike photographic products, once the tax has been paid on those other items (as for example, on a television set) they can then be enjoyed without further payment of excises. With still or motion picture equipment there is a continuing tax on the supplies of film.

We submit that when the amateur photographer pays taxes on his photographic equipment and then *each time*, on the film which he uses, at present rates or all at a 20-percent rate (as proposed in the House bill) he will already have paid more than his share of excise tax, without also making his projector subject to tax.

3. Would act as sales deterrent and cause some loss of other revenue

A third important consideration is that to increase the tax burden and thus the total cost of a still or motion picture camera and projector by taxing the projector will evidently further thin out the market for camera and film sales, with indicated loss of tax revenue on these products, as well as acting as a deterrent on projector sales. Please note carefully the interdependence of these products, and the fact that anything which discourages the sale of one will prevent the sale of all the related equipment or supplies. This is a characteristic of the present photographic excises and, coupled with excessive rates, explains their especially regressive nature.

This industry has done an outstanding job of bringing personal motion and slide film pictures well within the reach of the majority of families. The equipment to record and project treasured scenes from family history is a source of great and lasting value and pleasure. To increase the total tax load on such equipment will in some measure undo the years of effort on the part of the manufacturers to bring the cost of this equipment down.

You will readily appreciate why we feel that to place a tax on "household type" projectors would be singling out an already overtaxed area for still further tax such as will place all of these products, not merely the projectors, under a still greater sales deterrent and at a still greater competitive disadvantage than now exists.

We, therefore, respectfully request that the proposed taxing of projectors be eliminated.

V. IN RESPECT TO BROADLY BASED EXCISES

Your committee has received various proposals suggesting that you consider establishing excise taxes on a very much broader base than at present and at much more bearable and much less hazardous and regressive rates than that of 25 percent or even 10 percent. In view of the fact that it seems that excise taxes will be a part of our tax structure for quite some time to come, may we respectfully suggest that this is an opportune time to reappraise the impact of excise taxes on the presently selected industries and to develop an excise tax structure which will fall much more equitably and with much less discrimination on a very broad base. Regardless of their merits at the time imposed, we believe it is evident that today the present excises do not represent a fair selection of so-called luxuries nor do they in general represent any other reasonable or equitable basis of selection.

If your committee should decide to recommend a fairer spreading of the excise tax burden by adopting a very broad base and a much more bearable rate of tax at the manufacturers level, we especially ask, in equity, that the level of the photographic excises be reduced to this lower rate. If, on the other hand, your decision should be that broadly based excise taxes should be imposed at the retail level, we submit that in all fairness photogrophic excises (among others) at the manufacturers level should be repealed. Again, may we emphasize that our plea is for equitable treatment.

VI. CONCLUSION

In this brief we have presented information concerning the especially adverse, discriminatory and inequitable characteristics of the photographic excise tax law, and the great need for the technical amendment to section 3406 (a) (4) Internal Revenue Code which is provided in section 485 of H. R. 4473.

In doing so we have sought not to burden you by repeating supporting data and details which were fully brought out in our testimony and brief of July 7, 1950 (p. 250 et seq., hearings before the Committee on Finance, 81st Cong., on H. R. 8920). Attention, however, is called to the fact that this material is still pertinent to your present consideration of this matter.

We have reminded you of the key strategic importance of the photographic industry and photographic products and that in time of war the main impact of the photographic excises is on the armed services and on defense-supporting effort, adding importantly to the cost thereof.

In more normal times these taxes principally add to the cost of education, business, research, science, government, and similar important activities. They are an adverse discriminatory force preventing the photographic industry from fully enjoying its reasonable and proper markets and placing it under serious special hazards of a most inequitable and undesirable nature.

The present rates, established in 1942, are discriminatory and excessive. These rates, coupled with the seriously deficient wording of the present law, have caused injury and hardship above and beyond those normally associated with excises.

It is to be remembered that any failure to revise the faulty language of the existing law would leave the industry and the Internal Revenue Bureau still plagued with the administrative and interpretative difficulties which persist even at this late date.

It would still leave important segments of this industry exposed to the unfair competitive situation wherein their taxed products must compete with the same or similar products which nonphotographic manufacturers can sell without tax. It would still continue to act as a drain on the working capital and add to the cost of doing business of the many thousands for whom photographic products are livelihood tools, production machinery, and equipment or operating supplies. It would still continue to adversely affect sales and thus seriously limit employment opportunities throughout the entire photographic industry.

Section 485 of H. R. 4473 contains a very thoroughly considered technical revision of the wording of the present law. It would provide a much needed simplification of the application of this tax and would relieve the industry of the uncertainty and the unfair competitive situations of the present law and the Internal Revenue Bureau of the almost impossible task of equitable interpretation and administration presently encountered.

We believe, that it would be overburdening the industry to make projectors also subject to tax as is proposed in section 484, and therefore have requested the elimination of this item.

We believe that section 485 of the proposed bill is fair, in view of the need for revenue, although we do wish to point out that the tax to be levied on the amateur photographer is still in excess of that which is proposed for practically all other goods at the manufacturers level. It is difficult to understand how the home use of photographic products can be considered more of a luxury than that of numerous other products which either are not taxed or which are proposed to be taxed at only 10 or 15 percent. If it seems necessary, however, for revenue purposes, to retain the 20 percent rate of section 485, we will not object to it in view of the fact that the technical rewording provided by this section accomplishes such urgently needed change.

In view of the known discrimination against this industry as to the rates and the inequitable imposition of this tax, we believe your committee will recognize that it is entirely warranted in acceding to our requests at this time. Despite the very small net loss of revenue which would result, such corrective action would provide a very great stimulus and desirable measure of reasonable security to an industry which promises to become of even greater vital importance to the security of the country.

We, therefore, respectfully urge the importance of favorable action by your committee with respect to our requests.

Respectfully submitted.

NATIONAL ASSOCIATION OF PHOTOGRAPHIC MANUFACTURERS, INC.,
By WILLIAM C. BABBITT, *Managing Director*.

Senator BYRD. Mr. Crowell; Mr. Alan W. Crowell, will you please identify yourself.

STATEMENT OF ALAN W. CROWELL, SALES MANAGER, ZIPPO MANUFACTURING CO.

Mr. CROWELL. Mr. Chairman, I am Alan W. Crowell, of the Zippo Manufacturing Co., of Bradford, Pa., appearing on behalf of the flint lighter manufacturers' group in opposition to the proposed 20-percent excise tax on all mechanical lighters.

We feel wholly justified in opposing a 20-percent retail excise tax on mechanical lighters as provided in H. R. 4473.

The manufacturers of lighters were not afforded an opportunity to be heard by the House Ways and Means Committee; we, therefore, rely on the members of the Senate Finance Committee to decide whether or not this tax will be more harmful than beneficial to the Government, public, and the industry.

We respectfully submit the following eight points which outline our position in opposing this 20-percent excise tax:

1. Lighters are a smokers' accessory: Lighters are strictly utilitarian smokers' accessory which are rightfully regarded by the general public and the Armed Forces as a necessity from the standpoint of use and economy. Thus, mechanical lighters will be the only smokers' accessory bearing an excise tax.

2. Some lighters are already taxed: We would like to call your attention to a portion of the report of the Committee on Ways and Means, House of Representatives, accompanying H. R. 4473 (p. 50, pt. D-1), which reads, in part, as follows:

> Many of the more expensive types of lighters escape taxation under the present law, while some of the relatively less expensive ones are subject to tax. For this reason, section 431 of the bill extends the 20-percent retail tax on jewelry and related items to all mechanical lighters for cigarettes, cigars, or pipes.

Senator BYRD. You bring in about $2,000,000, do you not?

Mr. CROWELL. Yes; it is estimated that it would.

Senator BYRD. Did they have hearings on this in the House?

Mr. CROWELL. No; there were no hearings, no opportunity for hearings.

Senator BYRD. All right.

Mr. CROWELL. The point I wanted to make there was that the price-list catalogs of any lighter manufacturer would quickly prove the inaccuracy of this statement upon which this proposed tax is predicated.

Senator MARTIN. Mr. Chairman, I am not just clear on that. Maybe the witness will explain. Some lighters are now taxable, and why it would be that extending it to all would be unfair. That is just the thing I do not understand. I would like to have a further explanation of that.

Mr. CROWELL. I would be glad to submit here the price lists of a number of manufacturers indicating the items that are taxed, because they are ornamented with precious metals or plated with precious metals.

(The price lists submitted were made a part of the committee file.)

Senator MILLIKIN. The theory is that it is a luxury tax.

Mr. CROWELL. A luxury tax. Those that do not carry a tax—all other lighters except those adorned with precious metals do not carry a tax, and they make up the bulk of the lighters sold.

Senator MARTIN. That makes it clear. I did not quite understand it.

Senator KERR. Just like fountain pens and pencils.

Mr. STAM. That is jewelry.

Senator KERR. If they have ornaments on them, they are taxed, and those that do not have them are not taxed.

Mr. CROWELL. That is right; and the implication in the House bill is mystifying. It does not point it out that way.

Lighters made of or ornamented with precious metals already bear a 20 percent tax. We do not protest the continuance of this tax. However, we strongly feel that it is wholly unfair to broaden this tax classification to include all mechanical lighters.

3. Materials shortages: Production and sales of mechanical lighters are materially reduced already by restrictive Government orders on the use of critical materials.

4. Tariff favor imports: American lighter production and sales are seriously threatened by the importation of inexpensive foreign lighters which are favored by low tariff rates.

Senator MILLIKIN. Where do they come from?

Mr. CROWELL. From Austria and Japan.

In fact, that is referred to in this next statement here. I think it would be clearer to finish the statement and we will have time for any questions then.

A. Imported copies of American lighters are being sold now at prices which make it impossible for the American producer to compete. A great many of these imported lighters are brought in from Europe and Japan by a subterfuge. On low-priced pocket lighters there is a duty of 110 percent, but on table lighters the duty is only 30 percent. Large quantities of pocket lighters are now being imported to which cheap temporary bases are attached, so that they may be declared as table lighters and thus be brought in under the lower 30 percent duty. Consequently, the Government is losing 80 percent of the duty it is entitled to collect.

Senator MILLIKIN. What are you folks doing about that?

Mr. CROWELL. We have not been able to accomplish any relief.

Senator MILLIKIN. Have you tried?

Mr. CROWELL. We have tried, and I would submit a letter to the Collector of Customs, which expands the situation on import duties, for the table lighter, the so-called lighter, is coming in now as a table lighter. In other words, it changes from a table lighter very readily through the attachment of a base which can be thrown away.

Senator MILLIKIN. We have just finished passing a law which gives relief against misclassification.

Mr. CROWELL. Yes, and point B here says that the provisions made at the Torquay Conference, further lowering the import duty on pocket lighters, are expected to increase this flood of cheap imported lighters.

Senator MILLIKIN. All I am trying to suggest to you is you have got more relief possibilities than you have ever had before, and I am wondering what you are doing about it. You have got relief against misclassification, and you now have escape clause provisions you did not have before. I wondered if you knew about it and what you are doing about it. I am making a friendly inquiry, trying to help you.

Mr. CROWELL. You may have some suggestions on that.

Senator MILLIKIN. I have made all that I am going to make.

Mr. CROWELL. We can get that.

To further point out this subterfuge, there is a letter received by one of our members recently, where they point out specifically that, incidentally, the base is only put on to avoid higher duty.

The duty on table lighters is 80 percent and on ordinary lighters 110 percent.

We learned that this base will be thrown away in America.

As further evidence, here is a Macy's advertisement which specifically states in the text, "Remove the base and it is a pocket lighter."

Senator MILLIKIN. It is an obvious trick to get a favorable classification, and we have just recently restored relief against that very kind of practice.

So I am just dropping you a hint.

Mr. CROWELL. I thank you, sir, and we will put that into the record.

Senator MILLIKIN. We also have new authority for quota provisions. You get an import situation with a country like Japan, and they can put stuff in here with such a low price that you cannot reach it with tariffs.

Maybe the only way you can reach it is by quotas. I am giving you another hint.

Mr. CROWELL. That is very good, because at that low price it is still competition that cannot be met adequately by American-made products.

Senator MARTIN. The big difference in cost is wages, is that right?

Mr. CROWELL. Low wages on the other side, but in addition——

Senator MARTIN. What Senator Millikin has suggested I think, if American industry would give cognizance to a lot of these things in this session of Congress and the previous session, we have been trying to eliminate those inequalities, and to eliminate where there is trickery, and of course, we have got the Tariff Commission to regulate rates.

I can see where an industry like yours can be very greatly damaged by importations from other countries where the wage rate is probably not more than one-fourth to one-tenth of what ours is in America.

Mr. CROWELL. That is very significant. Another factor allied to this is that foreign producers can supply lighters to this country made with basic and finishing materials that are barred or restricted to American manufacturers.

One illustration: All of these are illustrations of imports. They still have the privilege of using the critical materials.

Senator MARTIN. Has any of your industry—have any of your factories any place—has it been necessary to curtail your production by reason of importation?

Mr. CROWELL. Yes; it has.

Senator MARTIN. That has affected employment?

Mr. CROWELL. A case in point there is indicated by the volume of imports dating from 1946 on. In 1946 approximately 16,000 lighters were imported; 80,000 lighters were imported at a value of $16,000, and during the year 1950, about 6,000,000 lighters were imported, valued at approximately $1,275,000.

Senator MILLIKIN. What is the total domestic market on lighters, how many million?

Mr. CROWELL. There are not any facts accumulated to indicate what that is. They just are not available. Each company knows its own, but there has never been an accumulation.

Senator MARTIN. The companies making lighters, I guess, are usually rather small local concerns.

Mr. CROWELL. That is right.

Senator MARTIN. Like the one in Bradford, Pa.?

Mr. CROWELL. We are a small company in a relatively small industry.

Senator MARTIN. But it means a great deal in employment to a community of that size.

Mr. CROWELL. Yes, sir.

Senator MILLIKIN. As another test as to whether you are entitled to relief, it is whether imports are hogging an undue share of our domestic market; so you had better be getting some statistics together on that.

Mr. CROWELL. It would be very helpful. The company feels the impact when we meet the wholesaler and meet the retailer and see the volume of lighters that he has on imports versus the volume he is buying from us.

Senator MILLIKIN. You have a job for your legal eagle.

Get your legal eagle busy and he will get you out of a lot of your troubles.

Mr. CROWELL. You bet.

Now, No. 5, the significance of tax yield: The framers of the 1951 tax bill have estimated that a 20-percent retail excise tax on all mechanical lighters will provide $2,000,000 annually. This is in addition to the present tax on lighters made of and/or ornamented with precious metals. This $2,000,000 represents less than three one-hundredths of 1 percent of the total of $7.2 billions sought. Recognizing materials shortages and the adverse effects of the tariff, this tax, small as is the yield, may very well have a crippling effect upon the American lighter industry.

6. Effect on trade channels: Mechanical lighters are distributed and sold through about 6,000 wholesalers and 300,000 retail outlets. Of these retailers, a large segment—particularly the neighborhood store—does not traditionally handle merchandise on which an excise tax must be collected. Hence, many retail stores will discontinue handling lighters rather than be bothered with record keeping and making excise-tax remittances. This will adversely affect the wholesaler.

7. Effect on employment: Our industry employs nearly 15,000 people. Their employment depends upon our ability to maintain production and sales of mechanical lighters at adequate levels.

8. Contribution to defense: Our mechanical facilities and the know-how of our employees served during the last war and are again active in the present program. Even a partial curtailment of this industry's ability to produce will, in effect, impair our value to the defense effort. If our volume decreases, the industry will not be able to sustain a sufficient and sound financial condition to undertake defense work.

Senator MARTIN. I understand that you are a great deal like the watch industry. You train a great many men with the know-how to do certain things in defense work, and if these men are not employed, they get into something else, and you lose them.

Mr. CROWELL. We have a number of women in the industry, most of the companies have a number of women, many of them older women who can do certain light work, and they do not fit into other types of heavier work.

The reserve is there to be used as needed in something that can be handled.

In summing up, I would just like to——

Senator MARTIN. I would like to make this suggestion. I do not think you can put on a high enough tariff to make up the difference between the wage scale, we will say, in Japan, and our country. This would have to be by quotas. You have to take advantage of those.

Mr. CROWELL. Even the 110 percent would not solve the problem, but during this period when that has been available, it has sapped income that justifiably belonged in the Treasury. So, to sum up, for the above eight reasons, this industry opposes the 20-percent retail excise tax on all mechanical lighters. May I remind you again that the estimated yield of $2,000,000 represents three one-hundredths of 1 percent of the $7,200,000,000 sought.

The lighter industry is a relatively small industry made up largely of owner-managed firms, whose employment and payroll play a significant part in the economic life of the communities in which they are located.

For this reason we urge serious consideration of the effect of a tax which would disturb the stability of the small communities dependent on these small industries.

Now, we have purposely kept that written brief to a minimum to cover any other questions that might come up.

Senator BYRD. You have taken about 20 minutes.

Mr. CROWELL. Really?

Senator BYRD. Most of it was questions.

Mr. CROWELL. I would not have believed it.

Senator BYRD. Thank you very much, indeed.

Mr. CROWELL. Thank you.

(The documents referred to by Mr. Crowell are as follows:)

THE FLINT LIGHTER MANUFACTURERS GROUP,
New York 16, N. Y., July 12, 1950.

Mr. FRANK LAUGHLIN,
Deputy Collector of Customs, New York.

DEAR SIR: The Flint Lighter Manufacturers Group founded in 1942 and representing approximately 90 percent of the volume of cigarette lighters produced in the United States herewith makes formal application for a change of practice and for the proper assessment of import duties on imported cigar and cigarette lighters now being erroneously designated at "tablé lighters' by the customs service.

Taking the criterion of the Customs Bureau that an item which is designed to be used or worn about the person" is subject to a duty of 110 percent we submit that the vast majority of lighters now being imported as "table lighters" are so designed only because of the practice of skillful but obvious subterfuges, if not actual fraud and deceit. The resultant loss of revenue to the Government caused therefrom must be tremendous.

We admit that there are some lighters which have been designed as table lighters and which are correctly assessed at the 30 percent import duty. These lighters have obviously been designed and manufactured as table lighters, by virtue of a substantially heavy base, the base being an intrinsic and necessary part of the lighter and being permanently attached thereto.

However, this application is made for a change of practice in regards to the vast number of pocket lighters which were designed as such and to which an inexpensive and readily detachable base has been added solely for the purpose of avoiding the legitimate 110 percent import duty.

The exhibits which are being submitted herewith and made a part hereto are typical.

As to these lighters and many like them which have a detachable base, we contend that by no stretch of the imagination can they be considered as table lighters because—

1. These lighters were designed as pocket lighters and are sold in their country of origin as well as exported from there to contries other than the United States as pocket lighters.

2. The surveys made by the members of our industry showed that the retailer rarely offers, sells, or exhibits them as table lighters or even supplies the base along with the lighter. And where bases are supplied it is done so merely in continuing the fiction established by the importer.

3. When the base is still on the lighter it is not possible to service the lighter with flint or fluid without removing the base.

4. It is obvious that in most cases the base is so cheaply constructed as to negate its use upon a desk or table, because the sharp edges would quickly scratch a finished surface.

5. To further substantiate our allegations as to the subterfuge and deceit, we submit a photostat of a letter from England wherein it is openly stated that the base is only put on to avoid the higher duty assessed against pocket lighters.

It may be contended that the determination reached in *Hecht-Pearl Co.* v. *U. S. A. C. C. P. A.* (171 T. D. 44875) grants the blanket authority to consider any lighter a table lighter as long as some pretense is made of attaching a base to a lighter.

We submit that such is not the intention of the ruling. The decision was only dispositive of the issue under judication at the time and only as to the item which was the subject of complaint then made.

To construe that decision to apply to all lighters, which by subterfuge and fiction only masquerade as table lighters for the sole purpose of escaping proper duties would be a mockery of justice and at variance with common sense procedures.

Very truly yours,

FLINT LIGHTER MANUFACTURERS GROUP,
BERNARD RING, *Secretary.*

THE FLINT LIGHTER MANUFACTURERS GROUP,
New York 16, N. Y., July 12, 1950.

Mr. FRANK LAUGHLIN,
Deputy Collector of Customs, New York.

DEAR SIR: Together with our letter of the same date we are submitting herewith exhibits as enumerated below. In connection therewith we wish to say that a table lighter is usually an ornamental piece and if it is produced as a table lighter, then the base is at least of the same material and the same finish as the body of the lighter itself. These exhibits will show that neither one of these points holds true in the case of the imported lighters.

Exhibit A.—A pocket lighter manufactured by Bowers Tool & Die Co., of Kalamazoo, Mich., with a ring on the bottom to permit attaching it to a key chain.

Exhibit B.—A copy thereof manufactured in Japan and shipped to the United States with a base to escape paying the proper duty.

Exhibit C.—A pocket lighter manufactured by Dzaman Machine Shop, of Bordentown, N. J.

Exhibit D.—A copy thereof manufactured in Japan and shipped to the United States with a base to escape paying the proper duty.

Exhibit E.—A pocket lighter manufactured by Regens Lighter Corp., of New York, N. Y.

Exhibit F.—A copy thereof manufactured in Vienna, Austria, and shipped to the United States with a base to escape paying the proper duty.

Exhibit G.—An additional copy thereof manufactured in Japan and shipped to the United States with a base to escape paying the proper duty.

Exhibit H.—A pocket lighter manufactured by Aladdin Lighter Co., of New York, N. Y., with a ring permitting attaching it to a key chain. This lighter by virtue of its size cannot be considered a table lighter if imported with a base.

Yet samples of this lighter have been shown to obtain orders for later delivery with a base attached thereto to escape paying the proper duty.

Another model of this lighter, slightly larger, with a chain and bell attached have also been shown.

We trust that these exhibits will clearly indicate our case.

Very truly yours,

FLINT LIGHTER MANUFACTURERS GROUP,
BERNARD RING, *Secretary.*

BENLOW, LTD.,
Hayes, Middx., June 7, 1950.

Mr. and Mrs. JULIUS KOHN,
% the IMCO Manufacturing Corp.,
New York 11, N. Y.

DEAR MR. AND MRS. KOHN: I thank you for your congratulations on my marriage, and wish to convey the thanks and best regards from Mrs. Lowenthal.

Re Fishberg: I have taken note of your opinion and quite agree with you.

Thank you for the details you have given us regarding the pipe covers. You will hear from us as soon as we have the offers in hand.

Yours truly,

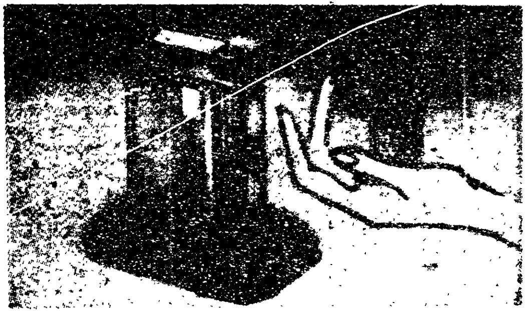
BENNO LOWENTHAL, *Managing Director.*

P. S.—We have just heard that Fishberg has bought 100,000 roller lighters made out of brass nickel, polished engine turned, with a small basin underneath at 1s. 9d., but this line gives no pleasure or profit to anyone over here. We have just spoken to the manufacturer and he said that after the first 100,000 they can make them themselves in America because business without profit is uninteresting. This is only for your information. Incidentally, the basin is only put on to avoid higher duty. The duty on table lighters is [illegible] percent and on ordinary lighters 110 percent. We learn that the basin will be thrown away in America.

B. L.

DAILY NEWS, FRIDAY, MAY 26, 1950

ENGLISH LIGHTER FOR TABLE, FOR POCKET



98c SALE

Macy's price would have been 2.79, if not specially purchased

Only Macy's has this handsome lighter in chrome plated metal. Well made for long life. It's convertible. Use it on the table . . . remove the base, it's a pocket lighter. Fine for home—wonderful for gifts. Write, phone (LAckawanna 4-6000) for 3 or more. Tobacco Shop, Street Floor and Table 34.

(Dept. 36)

HOME STYLE COOKIES IN COLORFUL TIN BOX

IMPORT OF MECHANICAL CIGARETTE LIGHTERS UNDER THE INCORRECT CLASSIFICATION OF TABLE LIGHTERS PAYING A 30-PERCENT IMPORT DUTY INSTEAD OF THE 110-PERCENT IMPORT DUTY APPLYING TO POCKET LIGHTERS

The following figures were compiled from the Import Bulletin published by the Journal of Commerce, New York, and listing the arrival each week of dutiable imports.

The Import Bulletin lists the arrivals in cases. We have taken as an average that each case contains 5 gross of lighters and that the average price of each lighter is approximately $0.20. From this we arrive at the following figures:

Year	Cases	Amount	Year	Cases	Amount
1946	111	$15,984	1949	686	$98,784
1947	185	26,640	1950	8,159	1,275,996
1948	630	90,720	1951, to May 31	1,856	267,264

Senator BYRD. Mr. Poteet.

STATEMENT OF J. R. POTEET, VICE CHAIRMAN, EXCISE TAX ADVISORY COMMITTEE OF THE NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION

Mr. POTEET. Senator, in the front of our brief I have a summary, but I would like to support it with a few remarks in the brief itself, if I may.

Senator BYRD. Very well.

Mr. POTEET. I am J. R. Poteet, vice chairman of the excise tax advisory committee of the National Electrical Manufacturers Association, whose member companies produce at least 80 percent of the total output of the electrical-manufacturing industry.

Eighty-two of the member companies make products which are subject to a manufacturers' excise tax under sections 3405 (a) and (b) and section 3406 (a) 3 of the present Internal Revenue Code. These products include ranges, water heaters, refrigerators, farm and home freezers, commercial cooking equipment, air circulators, air heaters, fans, and many houseware items, such as toasters, coffee makers, food mixers, roasters, flat irons, warming pads, and so forth. Some of the member companies also manufacture dishwashers, garbage disposal, and other electrical appliances upon which it has been proposed to levy an excise tax. Seventy-five to eighty percent of the total sales of these electrical products are accounted for by these 82 manufacturing companies.

The rising standard of living of our country has been marked by the transition of the products of our economy from luxuries to necessities.

For example, the overwhelming adoption of mechanical refrigeration has practically removed the old ice wagon from the streets, any any attempt to return to earlier ways of refrigeration would produce widespread inconvenience and economic upset.

Therefore, mechanical refrigeration—a luxury 20 years ago—has become a necessity and does an immensely better job of safe and lower cost preservation of food and prevention of spoilage.

Take another example; practically every home in this country has a cook stove. Cook-stove purchases are usually for replacement of equipment that is obsolete, inefficient, and hazardous. Nine million, or 25 percent, of American homes cook with electricity and 60 percent cook with gas. To replace electric, gas, or oil stoves, as they wear out, with untaxed cook stoves, would require a complete economic reorientation of the method of supplying cooking heat and would be obviously impractical. Good, old untaxed wood and coal stoves have become expensive luxuries.

One more example; hot water, and plenty of it, is necessary in every home, for sanitation and to prevent infection and disease. The automatic hot water heater, which makes hot water immediately available upon demand, is essential for healthful living.

Most modern home builders install these three major appliances, a range, water heater, and refrigerator, as part of the basic household equipment, just as they install heating, lighting, and plumbing systems.

The electric flatiron used in 95 percent of the homes in the United States has long been recognized as essential. Electric blankets are now being prescribed for arthritic patients and the elderly. Fans provide necessary ventilation in apartments and other dwellings that otherwise would be like July in Washington.

These are but a few examples of household appliances which have long since ceased to be luxuries and have become household necessities.

It should be emphasized that the timesaving which electrical appliances provide is of increasing importance for the release of women for work in the many areas of usefulness, that have opened up to them—and this does not exclude work in defense industry and on the farm which require efficiency in the home and the minimizing of the time devoted to household duties.

The enormous contribution and the essential nature of electric appliances is, therefore, amply evident. If the taxation of luxuries were an objective, then electric appliances should be exempt.

However, it is not our endeavor to ask exemptions for the products we represent, for we know full well that defense requires substantial sums of money and that excise taxes should yield a fair share of the revenue for defense. We believe, however, that the present method of imposing excise taxes on a selective basis has created serious inequities.

Here's why:

1. Many items of considerably less essentiality are tax-exempt. Selective taxes penalize many newly formed families and low-income families who thus have to buy household appliances at higher costs.

2. Selective excise taxes have placed manufacturers of taxed items at an inequitable competitive disadvantage with manufacturers of untaxed items.

3. The thousands and thousands of small businesses, much of whose livelihood depends on the sale and servicing of these necessary household appliances in their communities, find their income inequitably curtailed by selective taxes as compared with their brother merchants handling untaxed items.

Faced as your committee is with the responsibilities of providing for adequate defense revenue, we wish to commend to you, in the light of the foregoing comments, the following suggestions:

First, we recommend broadening the base of excise taxes to include coverage of other consumer goods which are at present classified by the Department of Commerce under or as household operations.

This includes such items as furniture, drapes, floor coverings, china, glassware, etc. It does not include food, food products, drugs, medicines, and medical supplies.

Second, we recommend that the broader based tax be imposed at a uniform rate. Here are some cogent reasons for this recommendation.

1. Substantial amounts of revenue can be obtained from such a tax without excessive and discriminatory rates on any individual item.

In 1950 consumer expenditures for typical household goods were as follows (Department of Commerce classifications are used):

[Billions of dollars]

Furniture	3.3
Semidurable house furnishings	2.0
China, glassware, tableware, and utensils	1.5
Durable house furnishings	1.4
Floor coverings	1.0
Radio, television, pianos, musical instruments	2.8
Electric, gas, and oil appliances	3.0
Total	15.0

Current taxed items in the above account for approximately a third—nearly two-thirds are exempt from tax.

Just as an illustration, a 3-percent tax on all these items would produce revenue of $450,000,000. This is a greater yield than originally requested under the selective taxes proposed by the Treasury Department for collection at the manufacturers' level.

2. Under a broader tax base the consumer can buy what he needs without suffering a discriminatory penalty. On the other hand, under the present selective tax system, if a hot-water heater fails, the user has to buy a new water heater with a tax penalty, while his neighbor pays no tax on a $1,000 rug.

3. The tax will bear less heavily on low-income groups since their expenditures for the items now exempt, like food, normally constitute a greater portion of their income, than for those with larger incomes.

4. All household equipment industries and trades competing for consumer dollars will be placed on an equal footing.

5. Under a broadened tax base, present rates could be reduced without loss in total revenue from this group of products.

So, a uniform rate of tax appears to be both feasible and desirable.

Third, we recommend that the emergency excise tax, on a broader list of items, be imposed at the retail level and based on the cash retail price to the ultimate consumer.

This recommendation is amply supported by the following advantages:

1. With a retail excise tax the consumer pays the minimum and total net tax, and no more than the actual tax is collected. In its testimony before the Ways and Means Committee, the American Retail Federation pointed out that since a manufacturers' excise tax is an item of cost—here I quote—

> and must be financed at each stage of distribution, the tax is of necessity pyramided and produces additions to the retail price far in excess of the tax imposed. Thus the impact upon the price level is far greater than the amount of revenue produced by the tax. Because it is hidden in the price, at the various levels of trade, it has an impact on the cost of living, and on the consumer price index, greater than that of the tax itself.

2. Under a manufacturers' excise tax, wholesalers and retailers possess inventories on which a tax has been paid. So that when the Congress decides upon tax relief the very difficult problem of refund on floor stocks arises. The amount of tax greatly exceeds wholesalers' and retailers' net profit on appliances.

These businesses, most of which are modest in size and with limited capital, are thus faced with a serious financial threat, whether they attempt to absorb the tax, or accept the loss of business because consumers wait for the tax removal to be reflected in retail prices. Imposition of the tax at the retail level eliminates this problem.

3. As revenue needs change, the rate of the retail excise tax can be readily adjusted with minimum confusion and without hazard to wholesalers or retailers.

4. The tax is not hidden. We believe with the American Retail Federation, and I quote—

that it is sound policy to bring out all taxes into the open where they can be seen and recognized.

Opposition to a tax assessed at the retail level is usually based on an assumed high cost of administration and difficulty of enforcing compliance. Here is factual support for the contrary view.

1. The last significant tabulation of administrative costs in collecting State sales taxes was published by the Public Administration Service in 1945 and covered the years 1935 to 1941 inclusive. The highest percentages were 11 percent in Louisiana and 9½ percent in Connecticut during the first year of tax.

This was subsequently reduced to 5.7 percent in both cases. The average for 23 States having sales taxes for the period ranged between 2 and 2½ percent.

In 1948, 22 States and the City of New York had taxes at retail. Thus, a large number of retailers are equipped to handle retail excise taxes. This should help to reduce collection costs.

2. In 1943 the National Association of Tax Administrators recommended methods for effecting economies through joint efforts of local, State, and Federal Government in the event of a Federal retail tax. We believe that these methods bear consideration and further investigation.

3. Costs of administration, of course, include cost of enforcing compliance. A simple check on compliance is readily available, since remittances of funds collected by retailers under a retail tax imposed at a uniform rate, can be checked against the company's sales report for income-tax purposes.

4. Also, stamps have been used as a very successful method of collection.

Fourth, we urge that this uniform, broader based, tax be clearly identified as an emergency tax and that a definite date of termination be designated, subject to extension, if necessary. Emergency excise taxes always adversely affect peacetime consumption, employment, and business activity. Delay and uncertainty as to their repeal or modification upsets dealer and consumer purchases. The Revenue Act of 1943 provided for termination of emergency excise taxes.

Fifth, we recommend that section 3406 (a) (3) of the present Internal Revenue Code be changed to refer specifically to products of the household type.

Under the present interpretation, commercial cooking equipment used in hospitals, hotels, restaurants, cafeterias, schools, and industrial in-plant feeding facilities and air-heating equipment of the industrial type are taxed. Since these are tools of business, which under the intent of previous congressional action were not to be subject to tax, we believe the above revision should be made.

Now, may I summarize my recommendations? They are five in number.

1. Broaden the base to include most household items.
2. Assess the tax at a uniform rate.
3. Impose the tax on the cash retail price at the retail level.
4. Identify the tax as an emergency excise tax.
5. Revise section 3406 (a) (3) to make it applicable to appliances of the household type only.

We believe such a five-point program will create favorable results as follows:

1. Substantial revenue will be collected without excessive rates on any one item.
2. The consumer will not pay a discriminatory tax on items he has to buy as compared to the present selective tax system.
3. No more than the actual tax will be taken from the consumer because he pays an unmarked-up amount.
4. The exemptions for food, medicines, etc., reduce the impact of the tax on low-income groups.
5. The program reduces to a minimum the price-inflation effect which is inherent in an excise tax imposed at the manufacturing level.
6. The recommended program offers Congress a simple method for adjustment of the rate to suit changing revenue needs without hazard to wholesalers and retailers.
7. With the adoption of such an excise tax progrem as an emergency measure, and the establishment of a repeal date, much confusion and year-to-year disruption of business activity will be avoided.

It has been a privilege and a pleasure to appear before you today. May I take this opportunity to thank you for the privilege of appearing here and ask that you consider our proposals and recommendations as a serious effort to meet your estimated revenue requirements and provide the degree of excise-tax equity required for the protection of this important segment of American business and the living standard of our people.

Senator BYRD. Thank you very much.

Mr. POTEET. Thank you.

Senator BYRD. Mr. Kelly.

STATEMENT OF THOMAS F. KELLY, REPRESENTING THE VACUUM CLEANER MANUFACTURERS' ASSOCIATION

Mr. KELLY. Mr. Chairman, my name is Thomas F. Kelly, and I represent the Vacuum Cleaner Manufacturers' Association, comprising 18 of the 22 manufacturers of vacuum cleaners in the United States and on behalf of this important industry respectfully request that no excise tax be imposed on vacuum cleaners.

We want to remind you that an excise tax of 10 percent was placed on vacuum cleaners in the Revenue Act of 1941, but that this committee—that is the Senate Finance Committee—in its wisdom removed this tax in the Revenue Act of 1948, for the reasons set forth at that time and which are still applicable.

It was our desire then, as it is now, to sell vacuum cleaners at the lowest price possible so that this great labor- and health-saving utility could be made available to the greatest number of people who should have a vacuum cleaner in their home.

According to the most recent information, 48.5 percent or 16,996,000 wired homes of this country are today without this appliance and a recent survey indicates the principal reason is its first cost.

The Treasury Department recommended a manufacturers' excise tax of 25 percent on vacuum cleaners; however, the Committee on Ways and Means of the House of Representatives have decided that no excise tax should be imposed on vacuum cleaners and we are requesting that you concur in their decision.

An excise tax of 25 percent would put in beyond the reach of most of the people who do not now own a vacuum cleaner located in every city, town, and village and along the rural electrification lines of this country.

Congress should not impose this tax to deprive these people of this great necessity as it is not only a great labor-saving appliance, but a safeguard to the health of our people.

We would like to point out the reasons briefly that a vacuum cleaner is an absolute necessity in every home and nothing should be done to increase its price.

First, it saves the time and energy of every housewife: The use of a broom or carpet sweeper, rather than an electric cleaner, more than doubles the time required for house cleaning. Using a broom to sweep a rug requires more strenuous work for a longer period than is spent with a vacuum cleaner and the dusting operations which of necessity follow the sweeping adds another time period probably equal to that spent in sweeping.

We, of course, want to point out that even a broom will not clean floor coverings that have now for many years been designed for vacuum cleaning—a dust-raising broom simply moves the surface dirt from one place to another and does not touch the disease-laden deeply imbedded grit.

As we progress further in a defense economy such savings of time will become even more important. More and more women will be called upon to play two roles—housewife and defense workers. No woman can help serve such national needs and simultaneously give necessary care to her home without the aid of such appliances as the vacuum sweeper and cleaner.

The people who do not now own a vacuum cleaner do their own housework and nothing should be done to deprive any housewife from purchasing a vacuum cleaner by adding this exorbitant tax.

It helps to protect human health: One gram of ordinary household dust collected by a vacuum cleaner—an amount equivalent to about a teaspoonful—was found to contain as many as 5,000,000 germs by Dr. Murray P. Horwood, associate professor of bacteriology and public health, Massachusetts Institute of Technology, Cambridge, Mass.

It is the lurking germs in household dirts that many times account for the occasional and otherwise unexplainable breaking out of some illnesses amongst the members of a family.

Tuberculosis has been very properly diagnosed as a house disease and the treatment prescribed for it well proves this fact. It seems reasonable to assume that the decline in the rate of tuberculosis victims is due partly at least, to the use of vacuum cleaners in about 50 percent of the wired homes.

Household dirt is well recognized as being both destructive to furnishings and a menace to health. Dirt imbedded in floor coverings unexposed to air and sunlight soon decomposes into filth in which disease germs of many kinds are propagated.

Let us picture a young mother with a baby that crawls on the floor—do not do anything to force up the price of a vacuum cleaner so that she cannot keep her floor coverings free of disease-laden dirt.

Are you going to deprive her of buying a vacuum cleaner—we are sure that your answer will be "No" and that you will decide, along with the Committee on Ways and Means, not to place an excise tax on vacuum cleaners.

Now about moth damage: It is a well-known fact that damage done by moths in the homes of our country is greater than the damage done by fires. It is also well-known that moths thrive best in dust- and dirt-infested fabrics.

Eternal vigilance in the removal of dust and dirt is the best moth protection that a home can have and without the aid of a vacuum cleaner, a satisfactory job in this regard cannot be done and hence an unavoidable exposure to expensive and distressing moth damage.

It is our understanding that the suggestion that an excise tax be imposed on vacuum cleaners, is to curtail the use of critical materials; gentlemen, a tax is not necessary for that purpose. The National Production Authority is doing a splendid job along this line.

The vacuum-cleaner industry is meeting this situation by substituting other less critical materials and we will continue to do so to help this great emergency.

In addition, the sale of vacuum cleaners has and will continue to be restricted by the credit regulations of the Federal Reserve System.

The vacuum cleaner is not a luxury. No other appliance has done more to relieve drudgery in the home, save the time of the busy housewife, help solve the moth problem, preserve home furnishings, and contribute to the health of the family and the Nation than the vacuum cleaner.

A vacuum cleaner is needed in every home—the home cannot be kept clean otherwise. There is no substitute for a vacuum cleaner because there is no place where a housewife can send her home to be cleaned.

Every home without a vacuum cleaner should be able to get one as reasonable as possible. Think of the farmers served with electricity through the REA. These people need and want vacuum cleaners. Are you going to force them and other people to pay greatly increased prices because of an exorbitant excise tax when they do not pay excise taxes on other comparable articles?

Why discriminate against this labor-saving appliance when there is no tax on brooms, carpet sweepers, mops, or any other appliance used in helping to keep the home clean?

It is a fact that the imposing of an excise tax of 25 percent on a vacuum cleaner raises the retail price sufficiently to materially affect its sale and overencourage the purchase of other appliances not threatened with this excise tax.

The average retail price of a vacuum cleaner in 1950 was approximately $79.50 and an excise tax of 25 percent would increase this to approximately $99.50, and would definitely place it out of reach of most of the 16,900,000 wired homes without a vacuum cleaner.

The manufacturer's price on the above-average retail price of 1950, would be approximately $39.75, therefore, the tax of 25 percent would be $9.94 on each average-priced cleaner but as the distributor or wholesaler and retailer is entitled to his mark-up on this new price—the customer has to pay an extra $19.88 to enable the Government to collect this 25-percent tax.

To indicate how important it is to have a vacuum cleaner to clean floor coverings and even bare floors, I want to tell you what happened during World War II.

When the production of vacuum cleaners was discontinued—the Federal Government immediately froze all vacuum cleaners in manufacturers' warehouse stocks and none were released until they determined what they considered sufficient for their requirements.

The United States Government understands the great need of having a vacuum cleaner from a labor-saving and health standpoint.

In closing we respectfully request that you will concur with the Committee on Ways and Means, and will see that no excise tax is applied to vacuum cleaners for these reasons:

1. It will increase the price of a vacuum cleaner to such an extent as to prevent it being purchased.

2. This great labor-saving appliance should be made available at as reasonable a price as possible.

3. A vacuum cleaner is a disease preventative and should be made available at a minimum cost to a customer.

4. There should be no discrimination—there is no tax on brooms, carpet sweepers, mops, and other appliances used in helping to keep the home clean.

5. While a vacuum cleaner is often referred to as an appliance—it is really a necessary utility in the home or wherever there are carpets or rugs or other homefurnishings, and, gentlemen, you are not taxing other utilities in a home such as the heating system, etc.

6. There has been no thought to impose a tax on homefurnishings and, therefore, no tax should be placed on vacuum cleaners that keep them clean.

7. Above all, do not put a tax on cleanliness and sanitation. There is no tax on soap, etc., and therefore, you should not place one on vacuum cleaners. The American housewife has an inherent desire to be clean and to have her home clean—do not do anything to make it more difficult for her to obtain a vacuum cleaner.

8. And, gentlemen, it is not needed to curtail the use of critical materials—the National Production Authority and the Federal Reserve System have and will continue to take care of that for the Government.

The Senate Finance Committee and Congress removed the excise tax on vacuum cleaners in the Revenue Act of 1948 and, for the same reasons, please concur with the Committee on Ways and Means of the House of Representatives and grant our request not to impose an excise tax on vacuum cleaners in the Revenue Act of 1951.

Thank you very much.

Senator BYRD. Thank you very much.
Next is Mr. Farr.

STATEMENT OF MORT FARR, PRESIDENT, NATIONAL APPLIANCE AND RADIO DEALERS ASSOCIATION

Mr. FARR. My name is Mort Farr. I am a retailer from Upper Darby, Pa., and have been in the retail appliance business for over 30 years but I appear here today as president of the National Appliance and Radio Dealers Association, to represent over 100,000 retailers and dealers who are employers of several hundred thousand salesmen and servicemen.

When you look to a source of revenue, just as when we look to a source of business, it is important to get some basic information about that source.

Our television business is an industry which while healthy and prosperous a few months ago, is now being harassed by a most unfortunate parlay of troubles causing consumer resistance or inability to buy.

Simultaneously we have been hit by:

(1) A 10-percent excise tax on television effective November 1, 1950;

(2) The Federal Reserve Board's interpretation of regulation "W," which created a clot in our arteries of commerce—while we were partially relieved from this by Congress recently, it will be months before we fully recover from the ill effects of this period. Many retailers can never recover.

(3) Income taxes which draw a larger than ever portion of our net profits and our customers' spending money; and

(4) New developments in television that have created a "wait and see" thinking among prospects.

Retail sales in July were off 50 to 60 percent from July of 1950. Sales to dealers in June 1951 were 58 percent below June of 1950 and 75 percent below first quarter of 1951 average. Factory inventories which a year ago never equaled a 1-week supply are now over 750,000 sets or over 18 weeks' supply at current sales. At manufacturers' prices this indicates a value of 125 millions. Inventories at dealer level are probably double that figure and at current rate of sales will be sufficient for 4 to 5 months' business. In my own case, we have over 400 sets on hand and it could take at least that long to dispose of them.

I have here a few ads which I would like to add to the record, clipped at random from newspapers around the country indicating that the present excise tax, which has been paid by the manufacturer to the Government and has been passed along to the retailer, is being paid by the retailer and not by the consumer. The manufacturer is not paying the tax. Neither is the consumer.

I submit to you gentlemen that prices such as these—one-half the original price, and ads reading 35 to 50 percent off—and you gentlemen in Washington, I suppose, are more conscious than some other cities of that—here is another at 40 percent off—that, I submit, is below the cost of the dealer for this merchandise, and it indicates that that tax, which was put on last November, and which started this slow-down hasn't been paid by the consumer to date.

It has been paid by the retailer, however.

These low prices represent heavy losses to the dealer and many times sets are being sold below cost in order to move inventory to obtain cash to run their businesses and to pay the taxes on last year's profits. If this trend continues, many dealers will be bankrupt. Bankruptcies among our dealers in the first 6 months of 1951 were 222 percent over 1950, whereas the rate among retail establishments generally has remained virtually unchanged.

We believe that any increase in the excise tax on radios and televisions will result in a net loss of revenue to the Government. Appliance and television retailers paid substantial income taxes in the last few years but in the 3 months past, indications are that because of reduced volume and selling at reduced or no profits most of them are operating at a loss and if the present trend continues, will not pay any income taxes this year and may have loss carry-backs. Manufacturers and distributors as well as other segments of the business such as broadcasters and entertainers will also pay much more taxes if not hampered by this proposed additional tax.

It has been proposed to you that the excise taxes against the appliance and television industry be increased beyond the present burdensome 10 percent to 25 percent.

The action of Congress in loosening regulation W consumer credit restrictions will serve to partially correct a horrible injustice against one phase of our economy. On behalf of the Nation's appliance and retail dealers, I am imploring you not to supplant this with another injustice which has comparable capacity for destruction.

We recognize that you do have a responsibility to the public and the Government to find revenues somewhere. We have made a sampling of thousands of dealers to learn their answer to this.

We sent them a card simply addressed that we were going to represent them here at our hearing, and asking them what we would say to the Senate.

I think you gentlemen will be interested if we leave this to find some of the comments from the folks back home, who are businessmen. They are men who run businesses, not just the average run of the American public.

I would like to leave these here as part of my statement, because I think you will be very much interested in some of the comments they have made.

We have made a sampling of thousands of them. By far the largest number of respondents urged that in the name of equality that the many business enterprises which are tax free—the cooperatives and the businesses owned and operated in behalf of theological and academic institutions which compete with those of taxpaying small-business men—be required to make their just contributions to the Federal revenue as do the rest of us.

Coming from Pennsylvania, I am not as conscious of these cooperatives, but apparently in the Middle West, where we have a lot of members, it is a real competitive threat to them, and they really feel it.

By imposing such taxes you would secure a comparable amount of revenue, you would be making more equitable distribution of the tax load, and you would avoid singling out one segment of our economy on which to impose additional tax burdens, thus cutting back on the contributions that are being made to the Federal Treasury from the present high, multiple taxes already being leveled against it.

Senator BYRD. Thank you very much.

(The appendix to Mr. Farr's statement follows.)

APPENDIX A

SAMPLE INSTRUCTIONS TO MORT FARR, PRESIDENT, NARDA, FROM INDIVIDUAL DEALERS

DEAR MORT: Tell the Senate this: This industry is sick enough—an additional tax would floor it.

PRICES, INC., *Norfolk, Va.*

DEAR MORT: Tell the Senate this: In our opinion the appliance industry by recent directives has been curtailed in the promotion of the industry far enough. This excise tax on appliances and TV would create a hardship on the appliance industry which is made up for the most part of small-business men who have invested their life savings in this business. It is my opinion if the Congress is really interested in seeking an avenue for further taxes they should look into the cooperatives, mutuals, and other non-tax-paying groups. Our industry is already taxed and to place a further hardship on individuals who need these appliances to preserve their present standard of living would certainly be a mistake.

GABLES, INC., *Harrisburg, Pa.*

DEAR MORTS: Tell the Senator this: Considering (1) present business conditions, (2) restrictive legislation, (3) present tax burden in the industy are compared with some others, an increase in excise tax would do terrific damage to the industry.

HOME APPLIANCE CO.,
Charlotte, N. C.

DEAR MORT: Tell the Senate this: Put on the 25-percent tax that will surely put 50 percent of us dealers out of business.

BIGALTE ELECTRIC CO.,
St. Louis, Mo.

DEAR MORT: Tell the Senate this: To levy a 25-percent excise tax on TV, would be to deal the death blow to an already staggering industry. Even a 10-percent tax is too much on an item priced in the range of that of TV. The gentlemen in Washington have got to realize that the public is carrying all that it can in the form of taxes. This present business recline in TV and other items is due to the fact that people have spent their limit—not buyers resistance.

DIRKSE ELECTRIC CO.,
Grand Haven, Mich.

DEAR MORT: Tell the Senate this: Once upon a time there was a window tax in England, so windows were left out or reduced. There is just as much sense in putting a penalty on appliances as distinguished from other necessities. Let's play taxes across the board, and there is no reason to discriminate.

SIMON HALLE,
Colorado Springs, Colo.

DEAR MORT: Tell the Senate this: Tell them, Mort, that television sales are almost nil now. With an added tax it will be finis for sure. They killed building and automotive, the lifeblood of the Nation, during each hard time. How are they going to raise the 60 billion taxes being spent without "good business."

THE ECLIPSE ELECTRIC CO.,
Canton, Ohio.

DEAR MORT: Tell the Senate this: That we feel the appliance and television business is penalized enough with high prices caused by hidden Federal taxes. There are other untaxed sources to be tapped.

BROCKTON PUBLIC MARKET, INC.,
Brockton, Mass.

Senator BYRD. Mr. Ingraham, please.

STATEMENT OF EDWARD INGRAHAM, PRESIDENT, THE E. INGRAHAM CO.

Mr. INGRAHAM. Mr. Chairman, and members of the committee, I am Edward Ingraham, president of The E. Ingraham Co. I am appearing on behalf of the Clock Manufacturers Association of America, Inc., of which our company is a member.

I have submitted a prepared statement, but with your permission I will not read it and will not follow it too religiously, but would like to have it made part of the record.

Senator BYRD. Very well.

Mr. INGRAHAM. I know you are all watching the clock. I have been watching it, so I will be as brief as possible.

I ran across a little statement the other day, I cannot help but bring to your attention.

Senator MILLIKIN. If you and others did not watch the clock, people in your business would be in a devil of a fix.

Mr. INGRAHAM. Yes; I would.

The statement I thought summarized things pretty well was: "Without timepieces punctuality would be practically nonexistent."

I do not think I have to go into any detail as to how much we look to timepieces, clocks, and watches, to measure our time, our schedules, and how necessary they are to all people. I will not elaborate on that at all.

The reason we are here is, of course, the Treasury Department has recommended an increase in excise taxes, and we certainly hope that the Senate Finance Committee will not consider that as far as clocks and watches are concerned, timepieces generally; in fact, we are going to ask that they consider repealing the present excise taxes.

The taxes are 20 percent on timepieces—that is, clocks—timepieces, with an exemption of alarm clocks selling under $5, they take a 10-percent excise tax; but all of the clocks take a 20-percent excise tax; whereas, the wrist watches and pocket watches take a 10-percent excise tax. They have been classified as jewelry.

At one time they were actually classified as jewelry, now they are under section 2400, the same section as jewelry. I want to show you a few examples, if I may, of a few comparisons.

Here, for instance, is a somewhat familiar wall clock, which you might have up here on your wall, which has an excise tax of 20 percent. Now you might compare that in your minds with a diamond ring, for instance, which is also taxed 10 percent.

Senator KERR. Taxed how much?

Mr. INGRAHAM. Taxed 10 percent.

Senator KERR. The diamond ring is also taxed 10 percent?

Mr. INGRAHAM. Twenty percent.

Perhaps an elephant might wear that for an ornament, but I do not think the human being would. I think that it is a useful piece of merchandise.

Here are two clocks which are somewhat familiar; I am not putting in plugs for my competitors necessarily, but these are Baby Bens with which my company has to compete. One has a radium dial; the maker feels he has to sell at over $5. It is priced at $5.75 and takes a 20-percent tax. It is the same as a faultless or flawless pearl.

I object as a competitor to putting my competitor's merchandise in the classification of flawless pearls. I do not think they are.

This clock, however, sells for $4.95 and, therefore, only takes a 10-percent tax.

But you can recognize the discrimination between the two categories when one clock, because it has a radium dial, takes a 20-percent tax, and another clock, because it has a plain dial and, therefore, can be made at a lower cost, takes a 10-percent tax. There is a great deal of confusion in the trade among sales people and merchants, and so forth, in distinguishing between the two classes of clocks. Here is 10 percent, and here is 20 percent for the same item except for the price brackets.

Here is another item, the ordinary kitchen clock, which the housewife has. That takes a 20-percent tax. That takes the same tax as a lorgnette.

Senator BYRD. What does that sell for?

Mr. INGRAHAM. I am not sure of the retail price, but ordinarily a clock like that would sell under $5. Some are $3.98, some $4.50, some higher. But that takes a 20-percent tax.

Senator BYRD. This 20 percent is in the existing law?

Mr. INGRAHAM. Yes; that is in the existing law. What we would like to see done——

Senator BYRD. Did the House make any change in the taxation of clocks?

Mr. INGRAHAM. It has not. At one time I understand that they were about to completely remove the tax, but they have not at present.

Senator KERR. They missed it.

Mr. INGRAHAM. Unfortunately for us.

Now, we have, for instance, a common cheap pocket watch, a low-priced watch. That will sell for perhaps two and a quarter. It is the old dollar watch, but unfortunately that has gone like the 5-cent cigar. That watch is taxed 10 percent.

You take these little slide rules you stick in your pocket, the same as you would this. They have no tax. This is just for illustration. That is a rugged durable watch. Would you like to see what I am talking about? [Tosses watches to committee members.]

Senator KERR. This must be your competitor's watch the way you are throwing it around.

Mr. INGRAHAM. These watches are what we happen to make, but we have all types, sizes, and styles.

Senator BYRD. Does it keep good time?

Senator KERR. This fell apart.

Mr. INGRAHAM. That must be a competitor's. Yes; it is.

Senator KERR. You better take this.

Mr. INGRAHAM. It won't hurt, I am sure. That is a competitor's watch.

We have these low-priced——

Senator MILLIKIN. I have witnesses that I am returning this to you.

Mr. INGRAHAM. We have these low-priced watches. Here is a Mickey Mouse, somewhat familiar—more of a toy watch.

Senator BYRD. What does the wrist watch sell for?

Mr. INGRAHAM. A watch like this sells for 98 cents up, all kinds of prices. Here is the Mickey Mouse at $5.95.

This watch I have on my wrist is $4.95, one of our make. They take a 10-percent tax. But you take a fountain pen if it does not have precious metal on it, there is no tax at all on it.

Senator KERR. Have you read the House bill?

Mr. INGRAHAM. Not in detail; no, sir.

Senator KERR. I think that takes care of that fountain-pen deal.

Mr. INGRAHAM. I say, without precious metals. I do not know the last word on that. Again I want to emphasize the point that we think the tax is discriminatory between the different brackets.

Senator KERR. You think it should be made 20 percent on all of them?

Mr. INGRAHAM. We would hardly like that. I went into a haberdashery the other day near the shop and asked the haberdasher what he paid excise taxes on. He said:

> I don't pay any excise taxes. I only pay excise taxes when I get men's costume jewelry for the Christmas trade. Then I have to pay excise taxes on it, on gold-filled and gold-rolled costume jewelry. On neckties, shorts, and so forth, there is no tax.

I had to go buy some lamp bulbs to the store of Charley Underprice, who handles everything under the sun in the way of appliances, kitchenware, curtains, cheap merchandise. I said, "What is your excise tax problem?" He said, "I pay excise taxes on clocks and lamp bulbs."

We do urge that you consider the repeal of excise taxes on clocks and watches. We consider the measuring of time a necessity today in this economy of ours.

Actually our salesmen tell us that their wholesalers tell them they are finding outlets that refuse to handle clocks and watches today because they are the only things that are taxed in the lines they handle, and they don't want to get mixed up in the excise tax on a few limited items. They say they have some dealers who will not bother with taxes—they will not bother with clocks and watches because of the excise taxes on them.

What we ask for, as I say, is the repeal of the tax on clocks and watches. We think it is improperly classified as getting into any section 2400. It should be classified, we feel, along with many other necessities of life, and either go scot-free from excise taxes or, if later on, it is essential that taxes be placed on all merchandise, they certainly should not go scot-free then.

We would like to have you consider in any event the removal of the 20-percent excise tax on timepieces generally and put them in the same category as clocks selling under $5.

In other words, a straight 10 percent if it is impossible because of revenue requirements to repeal the statute.

Certainly, we hope under no circumstances will you consider any increase in excises on clocks and watches, because we think the burden has been heavy enough already.

Actually the tax was put on as a wartime measure to discourage buying in 1941 when there was a shortage of clocks, and actually also the War Production Board authorized the production of these war alarms, which some of you may remember during the war, because there was such a demand for them from the consumer, and clocks at that time were rationed to the people. They had to get them on a certificate of priority.

But the War Production Board recognized them as a necessity despite the fact that they took steel and brass, and they authorized production. They also begged us for pocket watches. We supplied some pocket watches, but we were out of business and could not go into extensive manufacture. We also supplied wrist watches for the nurses after we had gone out of production. The War Production Board begged for it.

Thank you very much, gentlemen.

Senator BYRD. Thank you.

(Mr. Ingraham's prepared statement follows:)

Statement of Edward Ingraham on behalf of Clock Manufacturers Association of America, Inc.

Mr. Chairman and members of the committee:

My name is Edward Ingraham. I reside in Bristol, Conn., and am the president of the E. Ingraham Co. Today I am testifying on behalf of Clock Manufacturers Association of America, of which our company is a member.

This trade association is composed of 12 companies:

The E. Ingraham Co., Bristol, Conn.
General Time Corp., New York, N. Y.
The William L. Gilbert Clock Corp., Winsted, Conn.
General Electric Co., Bridgeport, Conn.
The Herschede Hall Clock Co., Cincinnati, Ohio.
The Lux Clock Manufacturing Co., Waterbury, Conn.
The Sessions Clock Co., Forestville, Conn.
Seth Thomas Clock Division of General Time Corp., Thomaston, Conn.
Telechron, Inc., Ashland, Mass.
Westclox Division of General Time Corp., LaSalle, Ill.
U. S. Time Corp., Middlebury, Conn.
The New Haven Clock & Watch Co., New Haven, Conn.

These 12 companies manufacture substantially all of the spring-powered and electric clocks produced in the United States. Four of these companies—Ingraham, Westclox, U. S. Time and New Haven—manufacture 100 percent of the nonjeweled, or clock-type, watches produced in the United States. Timers and other items are also manufactured by this industry, but household clocks and personal timepieces are its principal products.

We are altogether separate and distinct from the manufacturers of jeweled watches such as Elgin, Hamilton, and Waltham, who have their own special problems with respect to excise taxes. My testimony is strictly limited to our own clocks and nonjeweled wrist and pocket watches, and has nothing whatever to do with jeweled watches.

Federal excise taxes first became effective as to clock and watches on October 1, 1941 (title 26, U. S. Code, sec. 2400). The rate then was 10 percent. It was a burden on our industry at the time. However, on July 1, 1942, a WPB limitation order stopped the production of clocks for civilian use and the entire industry was completely converted to the mass production of war goods, including war alarms produced by three manufacturers under WPB orders. After July 30, 1942, and during all of 1943, 1944, and most of 1945 our production of clocks and watches ceased except for the production of war alarms and nurses' watches. These were sold on priorities for essential civilian use. Clocks and watches came to be in exceedingly tight supply.

In 1944 the excise-tax rate on clocks was raised to 20 percent except that the 10-percent rate was retained as to alarm clocks retailing at not more than $5 (title 26, U. S. Code, sec. 1650). At that time we were so fully preoccupied with war production that the industry felt little direct effect from these taxes. We noted the express provision in the revenue act that these were war taxes which would be automatically repealed at the end of 6 months after the termination of hostilities.

VE-day and VJ-day came and passed. On December 31, 1946, the President officially proclaimed the end of hostilities. Under the time limitation fixed in the 1944 revenue act these wartime excise taxes should have expired on June 30, 1947. But they did not. With an eye to the Government's fiscal position, the Congress adopted a resolution continuing excise taxes in effect indefinitely. The effect of this resolution was to change these onerous and discriminatory taxes from a necessary wartime expedient into an ordinary source of revenue.

That was over 4 years ago. The special wartime excises are still with us. Congress has not told us what "indefinitely" means, and when or whether we may expect relief from the excise-tax burden. It profoundly disturbs the clock and watch industry—and probably all others who are affected—to learn that the administration has asked that these selective and discriminatory excises be increased instead of repealed.

In brief, our industry's position is this:

(a) Excise taxes on clocks and nonjeweled watches should be repealed altogether.

(b) If not repealed, there certainly should be no increase in excises on these articles.

(c) If the Congress concludes that excise taxes on clocks and nonjeweled watches are not to be repealed outright, then the rates should be equalized in order to eliminate the confusion at the retail level which the present variable rates have brought about.

1. Clocks and inexpensive nonjeweled watches are necessaries which should not be subjected to discriminatory luxury-type taxes.

(a) *Necessaries.*—I want to show you examples of clocks and nonjeweled watches which are affected by the present excises. They are functional and utilitarian, designed for service and not for ornamentation. Manufactured of base metals, the clocks retail at from perhaps $2.25 for the simplest model to about $8 for the higher grades of ordinary clocks. Style models of the best quality may retail for much more. Standard models of nonjeweled wrist watches manufactured by this industry range in price generally from $3.98 to $14.95, with the bulk of sales centering around $5.95 to $9.95. Our pocket watches retail at even lower prices, from $2.25 to about $4.25.

These are all practical, commonplace, serviceable items of everyday use. The tempo of modern living makes all of us acutely aware of the demands of time, and more and more dependent on timepieces. In its special study entitled "Federal Retail Excise Taxes" (October 1947) the Treasury Department itself pointed out that "* * * most adults need some sort of clock or watch." The clocks and watches I have shown you are sturdy, accurate, and dependable, but are inexpensively priced to meet the limitations of the average purse. They are primarily designed and primarily used as timepieces, and are obviously not in the jewelry class. Nearly everyone uses an alarm clock to awaken him in the morning. No housewife could operate her kitchen or regulate her household without the help of clocks. Every office, shop, factory, school, and laboratory is dependent on clocks and watches for efficient operations. Watches are of vital importance in all forms of transportation; even every bus driver and streetcar operator needs one in order to follow his carefully timed schedule. To bring it still closer home, I doubt that there is a person in this room who is not wearing or carrying a watch. It is indispensable to his activities.

World War II showed just how essential alarm clocks are. In April 1944 the Office of Civilian Requirements made a survey to determine what essential civilian goods were in short supply. It found that of all the items surveyed clocks were in greatest demand. Nearly 12 million families were in immediate need of alarm clocks. It also found that the greatest majority of families attempting to buy alarm clocks suffered real hardship and inconvenience because they could not be obtained. As a result the War Production Board issued a special order [1] authorizing the production and distribution of new alarm clocks. The preamble to this order read in part as follows:

"The fulfillment of requirements for defense of the United States has created a shortage in the supply of alarm clocks and materials and facilities for producing them; and the following order is deemed necessary and appropriate in the public interest and to promote the national defense."

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[1] Limitation Order L–275, issued April 14, 1944, reported in vol. 9, Federal Register, No. 76, April 15, 1944, pp. 4008–4009.

There follows the authorization to produce a substantial volume of alarm clocks in the very midst of an intensive war-production program.

The same situation developed in the next year, 1945, when a further survey was made by the Office of Civilian Requirements. It disclosed an undiminished demand for alarm clocks, and continued hardship and inconvenience to the civilian economy because they were not available. The shortage was considered so critical that scarce materials were allocated for the production of alarm clocks. In its press releases of March 16, 1945 (No. 7524) and of May 22, 1945 (No. 8100) the War Production Board said:

"Despite tightening of the copper and steel supply, alarm-clock manufacturers are expected to be allocated sufficient material in the second quarter of 1945 to produce as many clocks as they can make without using facilities or manpower needed for war production in their plants * * *.

* * * * * * *

"In alarm clocks, for example, the Nation's buying intentions, if supply were ample, showed a walk in (demand) of 12,580,000 as against a demand for 12,-425,000 reported a year ago in a similar Office of Civilian Requirements survey. The extent of the shortages in the 12 articles is shown by the experience of families that actually tried to buy them in the first quarter of 1945. *The percentage of families reporting real inconvenience or hardship from their inability to purchase is just about the same for the corresponding items as it was a year ago. This percentage is the highest in window screening (70 percent), alarm clocks (71 percent)* * * *." [Italics supplied.]

Peacetime needs for clocks and watches are relatively no less acute than those of wartime. Our entire economy is geared to time, and personal timepieces are indispensable tools to every individual.

(*b*) *Not luxuries.*—Many years ago clocks and watches were distributed largely by the jewelry trade, as they had facilities for servicing the product. Clocks and watches were then perhaps logically put in the same category as jewelry. Thus it came about that they were classified with totally dissimilar items under the heading "Jewelry, etc." (sec. 2400) for excise-tax purposes. Other items grouped in this section include jewelry, pearls, precious stones, opera glasses, and lorgnettes. The same excise tax is applied to all of these articles. But how can you justify taxing a workingman's base metal pocket watch on the same basis as pearls and precious stones? What kinship is there between a lorgnette and a kitchen clock? None, so far as I can see, except that the same luxury-type tax is imposed on both.

The clocks and nonjeweled watches which I have exhibited to you are not luxuries by any stretch of the imagination. It is absurd to put this nearly 2-foot-wide electric wall clock, set up for the public's convenience, in the same class as a flawless pearl for tax purposes. But that is exactly what has been done; even this alarm clock and a perfect blue-white diamond are both "Jewelry, etc." for excise-tax purposes.

In classifying articles for excise-tax purposes Congress evidently adopted the Census Bureau grouping, which at the time included clocks and watches with jewelry items. Prior to 1950 the Census Bureau's classification of manufacturing activities listed "Watches and clocks" in a miscellaneous list (list No. 17) of product classes with "Jewelry and silverware" and other items. But beginning with its 1950 Annual Survey of Manufacturers, the Bureau has transferred watches and clocks to a new classification (list No. 16) entitled "Instruments; photographic and optical goods; watches and clocks." (See the pamphlet of instructions accompanying form MA-100 for the 1950 Annual Survey of Manufacturers.) Similarly, the 1950 edition of the Statistical Abstract of the United States lists watches and clocks under the classification, "Instruments and related products" and not under the "Miscellaneous manufactures" which includes jewelry.

I submit that Congress ought to reexamine its classifications of items selected to carry the special burden of excise taxes. Clocks and watches are basic implements of everyday use which do not belong in any of the excise-tax classifications. Specifically, they are not "jewelry" and should not be taxed as such. To put it in other words, an ordinary article should not be subjected to an extraordinary tax when like articles are not similarly taxed.

(*c*) *Discrimination.*—It follows that the excise tax is discriminatory because it applies to clocks and watches but not to other items of like character and of no greater essentiality. Our industry is penalized while others are favored by the unequal and illogical application of the tax.

In his special message to Congress early this year on the subject of new revenues the President said:

"I recommend, third, increases in selective excise taxes to yield 3 billion dollars. Under present circumstances, *these increases should be concentrated upon less essential consumer goods*, and upon goods that will be in short supply." [Italics added.]

It was proposed by the Treasury Department, however, that, among others, excises on clocks and watches should be increased. Any such increase would greatly aggravate the already unjustified discrimination against our products and our industry. The House of Representatives did not increase the rates in its bill, and we urge that the Senate should not under any circumstances consider an increase.

Comparisons are always invidious, and I will not list the many articles which are less essential than clocks and watches—or no more essential—and which are not burdened with Federal excise taxes. It is glaringly inequitable to select ordinary timepieces as the objects of taxes out of a great many other necessary items which remain untaxed.

I cannot refrain from pointing out that clocks and watches are, after all, useful measuring devices. Their important function is to measure time. But there is, to my knowledge, no other measuring device on which the Congress has levied excise taxes. Thermometers to measure temperature, scales to measure weight, rulers to measure distance, ammeters and voltmeters to measure electricity—even jiggers to measure whisky—all are exempt from excise taxes. Even the clock's primitive antecedent, the hourglass, enjoys freedom from Federal excises. Some of these tax-free articles are highly ornamented. But the practical, workaday, inexpensive clock and watch bear the full brunt of excise taxes.

I have had a photograph prepared which is attached to this statement. It illustrates what I have just pointed out—that clocks and watches are the only measuring devices on which excise taxes are levied. You will be interested in the display of a desk barometer and humidity recorder, a weather thermometer, a jigger for measuring liquor, a collapsible steel measuring tape, and other measuring devices which are not subject to the excise taxes which Congress has levied on mundane articles such as clocks and inexpensive watches. What distinction can be made in support of this discrimination?

The instances of other untaxed items—no more utilitarian or essential than clocks and watches, and many of them less so—could be multiplied manifold. They would only serve to emphasize the discrimination against our industry and our products, with the attendant problems of pricing and marketing.

We contend that Congress should give careful consideration to this situation, and should eliminate the discrimination by repealing excise taxes on clocks and watches.

2. Excise taxes are a special burden on the clock and watch industry

Our industry has experienced all of the typical problems and hardships which excise taxes have brought about. These—notably the curtailment of sales—have been thoroughly discussed by representatives of other affected industries. But we have one problem which we believe is peculiar to the clock-and-watch industry.

Our products are sold through a wide variety of outlets. Jewelry stores account for only a very small percentage of our retailers. Most drug stores, hardware stores, specialty shops, and even tobacconists and newsstands, have carried clocks and watches as standard merchandise. In some instances, particular stores have stocked no other article on which an excise tax must be collected. In other cases only a few such articles have been carried in stock. We have found instances where retailers are discontinuing the sale of clocks and watches. They are doing so because of the trouble and expense involved in collecting and remitting the tax on a few items and keeping the necessary records, and because of mistakes on the part of sales clerks. The result is that we have lost retail outlets solely because of the fact that our products are subject to an onerous excise tax. We are seriously concerned with such incidents because they suggest the possibility of a trend which might impair our facilities for retail distribution, primarily because of the effect of excise taxes.

This situation also illustrates again, and perfectly, the point which I made earlier in this statement—that so far as clocks and watches are concerned excise taxes are harmfully discriminatory and ought to be repealed.

3. The differential in excise-tax rates should be corrected

Originally, the excise-tax rate, under the 1941 Revenue Act, was 10 percent on all clocks and watches. In 1944 the rate on clocks was increased to 20 percent, except that alarm clocks retailing at $5 or less continued to carry a 10-percent tax. These are the rates which are in effect at this time. They have produced untold confusion at the retail level.

Under these rates an alarm clock retailing at $4.95 carries an excise tax of 10 percent, or 50 cents, and sells for a total price of $5.45. An ordinary clock without an alarm—such as an electric kitchen clock—also priced at $4.95, carries a 20 percent tax, or $1, for a total of $5.95. Here are two clocks, both with the same $4.95 price tag, on which the sales clerk must collect different amounts from the customer. The opportunity for confusion is evident, and it is not surprising that retailers are continually plagued with sales errors.

To make the situation worse, an alarm clock priced at $5.50 carries a 20-percent tax of $1.10, and a total price of $6.60, as against a 10-percent tax of 50 cents on a $4.95 alarm and a total price of $5.45. We have no doubt but that errors in collection of the tax have occurred in a large percentage of sales.

In another aspect the same problem presents a headache for the manufacturer, since in repricing an alarm clock he must have regard to whether it will move from the 10-percent excise-tax bracket into the 20 percent bracket.

We strongly request the committee and the Congress to eliminate this disparity in excise-tax rates. If it is decided that excise taxes must be continued as to clocks, only one rate should be applicable; it should be 10 percent on all clocks, instead of 10 percent on some and 20 percent on others. We ask that the committee give special consideration to our request on this point. If it is not deemed possible to repeal all excises on clocks, then we urge that the present law be amended to make the same rate of tax, to wit, 10 percent, applicable to all clocks of every type and price.

CONCLUSION

Summarizing the points I have made, in the first place clocks and inexpensive nonjeweled watches do not properly belong in the excise-tax structure at all. They are necessaries, and in no sense luxuries or "jewelry, etc." The excise tax has been described as "selective," but it is in fact indefensibly discriminatory against clocks and watches and the industry which produces them. It is an especially troublesome burden which we and our products should no longer be required to carry. We insist, therefore, that as to clocks and watches excise taxes should be entirely repealed; to consider an increase, as proposed by the Treasury Department, would be unthinkable.

Finally, if continuance of excises is unavoidable, it is our position that the confusion arising out of the existing double rate on clocks should be eliminated. There should be only one rate of tax applicable to clocks; that rate should not in any case exceed 10 percent, and the present law should be amended accordingly.

On behalf of Clock Manufacturers Association of America I urge the committee to repeal excise taxes on clocks and nonjeweled watches and thereby to relieve our industry of the special problems which they have created.

Senator BYRD. The Chair desires to put two insertions in the record in lieu of appearances, one from Mr. Floyd E. Jacobs, general counsel for the American Reciprocal Insurance Association, and one from Lester Smiley, of the American Chicle Co., of Long Island City, N. Y.

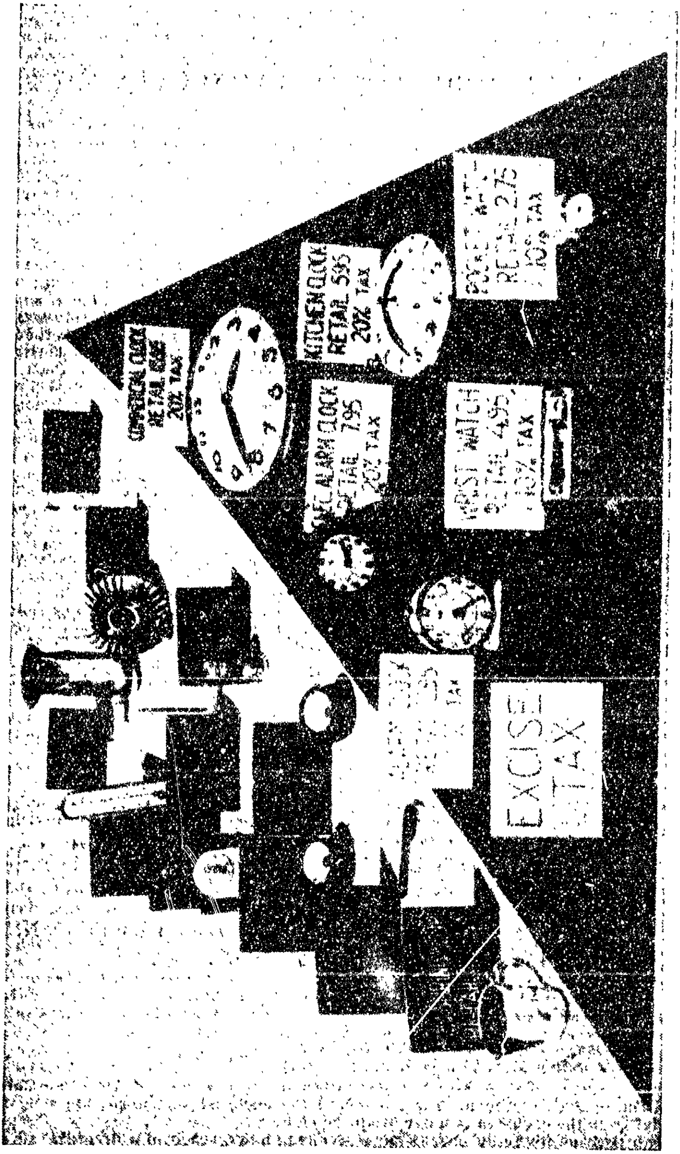
(The statements referred to are as follows:)

AMERICAN CHICLE CO.,
Long Island City, N. Y., July 31, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington 25, D.C.
(Attention Miss Elizabeth B. Springer.)

HONORABLE AND DEAR SIR: I respectfully request on behalf of American Chicle Co. the opportunity to file for the record the enclosed statement, applying for relief from the excise tax on our product Sen-Sen.

Our petition for relief has, as our statement shows, received a favorable report from the Treasury Department which indicates not only that our product has been discriminated against, as contrasted with similar products in its field, but


COMMERCIAL CLOCK
20% TAX
ELEC. ALARM CLOCK
RETAIL 7.95
20% TAX
KITCHEN CLOCK
RETAIL 5.95
20% TAX
WRIST WATCH
RETAIL 4.95
10% TAX
RETAIL 2.75
10% TAX
EXCISE
TAX

also that administrative difficulties would be greatly decreased if the tax were removed. In view of the fact that the House Ways and Means Committee has twice favorably acted upon this matter, we did not feel justified in asking time from your committee, but request permission to file our statement so that the matter may come before you for consideration.

Thanking you for any consideration that you may be able to give this matter, I am,

Very truly yours,

L. H. SMILEY,
Brand Manager.

STATEMENT OF LESTER H. SMILEY, OF THE AMERICAN CHICLE CO., OF LONG ISLAND CITY, N. Y.

My name is Lester H. Smiley and I reside in Jackson Heights, New York City. I am the brand manager of American Chicle Co., of Long Island City, N. Y., manufacturers of Sen-Sen confection.

We respectfully ask that the excise tax on Sen-Sen be repealed for the reasons that —

(1) Sen-Sen is being actually discriminated against in its own field.
(2) The loss of revenue would be negligible.
(3) The Treasury Department offers no objection.

Under the present Internal Revenue Code in section 2042 (a) the words "aromatic cachous" are interpreted by the Internal Revenue Bureau as including our product Sen-Sen. An "aromatic cachou" is technically defined as a silver-coated aromatic pellet made of licorice, cashew nut, gum, etc., for sweetening the breath. Our product Sen-Sen is not silver-coated, but it is in pellet form and has a licorice base. I know of no product upon the market today, or which has been on the market within the 23 years of my experience, which meets the definition of aromatic cachou. My research indicates that there has been no such product on the market since the turn of the present century. The nearest approach to the definition is our product Sen-Sen.

The reasonablenes of our contention that the tax should be repealed is evidenced by the fact that in the Eightieth Congress the House of Representatives passed a bill, H. R. 958, introduced by Hon. Walter A. Lynch, of New York, a member of the Committee on Ways and Means, which granted us the relief requested herein. Unfortunately, the bill reached the Senate too late in the session for action by your body. Again, in the Eighty-first Congress, the Committee on Ways and Means took favorable action on our request and gave us relief under the tax-reduction bill passed by the House in 1950. Again we were stymied when the Korean outbreak occurred and the tenor of the tax-reduction bill was necessarily changed by the Senate to a tax-raising bill.

In connection with H. R. 958, which gave us the relief sought, the Committee on Ways and Means made the following favorable report:

[H. Rept. No. 934, 80th Cong., 1st sess.]

The Committee on Ways and Means, to whom was referred the bill (H. R. 958) to amend section 2402 (a) of the Internal Revenue Code, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

The purpose of this bill is to exempt aromatic cachous from the retailers' excise tax on toilet preparations. Under existing law a tax of 20 percent is imposed upon such articles sold at retail. Aromatic cachous include Sen-Sen and other breath-sweetening pellets other than chewing gum or candy. The other articles subject to the excise tax on toilet preparations normally are applied externally. Moreover, aromatic cachous frequently are sold in competition with confections which are not subject to tax. As a result, administrative problems have arisen which would be eliminated with but minor loss of revenue by deleting aromatic cachous from the scope of the tax. The following favorable report was received from the Treasury Department:

TREASURY DEPARTMENT
Washington, D. C., June 24, 1947.

HON. HAROLD KNUTSON,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: Further reference is made to your letter, dated May 13, 1947, enclosing two copies of H. R. 958 (80th Cong. 1st sess.), a bill to amend section 2402 (a) of the Internal Revenue Code by striking from that section the words "aromatic cachous.' You request comments and recommendations of the Treasury Department on this proposed legislation.

Section 2402(a) of the code imposes an excise tax upon the sale at retail of certain specifically named products, including perfumes, cosmetics, hair dressings, toilet powders, aromatic cachous, etc., and any similar substance, article, or preparation; any of which are used or applied or intended to be used or applied for toilet purposes.

All products enumerated under section 2402 (a), with the exception of aromatic cachous, are customarily used and intended to be used for external application, whereas aromatic cachous are designed to be placed in the mouth and eventually swallowed.

It appears that an aromatic cachou, being a silvered aromatic pellet made of licorice, cashew nut, gum, etc., for sweetening the breath, is more in the nature of nontaxable competitive products such as mouth washes, liquid breath sweeteners, candy mints, etc., which are advertised and used for sweetening the breath.

Insofar as aromatic cachous and the latter-named nontaxable products are used for similar purposes, a discrimination results from application of the retailers' tax to aromatic cachous.

The removal of aromatic cachous from the class of taxable products would tend to decrease the difficulties of administration and it is believed would result in a negligible loss of revenue. No objection is therefore offered by this department to enactment of H. R. 958.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

Very truly yours,

A. L. M. WIGGINS,
Acting Secretary of the Treasury.

Another identical bill, H. R. 257, was introduced in the Eighty-first Congress by Representative Lynch. A report in substantially the same phraseology as the letter of Acting Secretary of the Treasury Wiggins of June 24, 1947, was received by Hon. Robert L. Doughton, chairman of the committee, from Thomas J. Lynch, then Acting Secretary of the Treasury, dated March 17, 1949. Upon the strength of these reports I am advised that the Committee on Ways and Means incorporated the provisions of Representative Lynch's bill, H. R. 257, into the general revenue bill of the Eighty-first Congress.

Speculating as to how the term "aromatic cachous" happened to appear in the toilet preparations section of the present law, we think it may have been continued, more or less by accident, after its first and possibly second appearance during the Civil and Spanish-American Wars respectively. We base this upon the following history of the appearance of this term, starting with an act of July 1, 1862, reading in part as follows:

"PERFUMERY AND COSMETICS: For and upon every packet, box, bottle, pot, phial, or other enclosure, containing any essence, extract, toilet water, cosmetic hair oil, pomade, hair dressing, hair restorative, hair dye, toothwash, dentifrice, tooth paste, aromatic cachous, or any similar articles, by whatsoever name the same heretofore have been, now are, or may hereafter be called, known, or distinguished, used or applied, or to be used or applied as perfumes or applications to the hair, mouth, or skin, made, prepared, and sold or removed for consumption and sale in the United States where such packet, box, bottle, pot phial, or other enclosure, with its contents, shall not exceed at the retail price or value the sum of twenty-five cents, one cent."

A similar stamp tax employing essentially the same language was imposed during the Spanish-American War by an act of June 13, 1898.

The next appearance of this tax was in the Revenue Act of 1917, then in the manufacturers' excise tax of 1932 and finally in the Federal excise tax of 1941 and 1944.

Originally, this tax was directed at imported breath-sweetening silvered pellets sold lavishly and often at fancy prices in phials and even in bulk form. In those days, there were a variety of products of this nature and all were taxed uniformly. Today, as stressed in Mr. A. L. M. Wiggins' letter, most items used for so-called breath protection are put up either in liquid or tablet form and thus do not fall within the meaning of the term "aromatic cachous." This results in a competitive disadvantage to our product Sen-Sen, which, to our knowledge, is the only product that is taxed under the present law. Sen-Sen is not a silvered aromatic pellet. However, it is in pellet form and is made with a licorice base and is perhaps the only product sold today that comes even close to the definition of the term "aromatic cachous."

Sen-Sen has always been sold principally at candy counters. Candy and cigar stores carry nothing other than Sen-Sen on which they are required to collect the Federal tax and thus this tax has had a crippling effect upon the retail distribution of the product, many stores preferring not to handle it at all rather than tabulate sales and fill out tax forms on Sen-Sen which is not important to their total business. Sen-Sen is a 5-cent product, making the amount of tax revenue derived therefrom more bother than it is worth to collect.

Candy and cigar stores in large numbers have discontinued the product and drug stores have removed it from the candy counter, where it belongs, to the cosmetic section where other taxable products are sold. The result has been that sales have suffered in relation to other products which we manufacture, by as much as 70 percent annually. The retailers who refuse to handle Sen-Sen or elect to display it in a department foreign to its nature are not prompted to do this because the tax is 20 percent, but because they refuse to be bothered collecting it. Hence a reduction in the amount of the tax would not rectify the situation under discussion. Outright elimination is all that will restore our product to its rightful competitive position.

Before departing from the history of the appearance of this term in excise-tax legislation, it should be pointed out that when it made its first appearance toothwash, dentifrice, and tooth paste were also embraced in the law, as were all perfumes applied to the mouth. The present law specifically names only products which are customarily used and intended to be used for external application, aromatic cachous—being interpreted as Sen-Sen—is the sole exception to this.

We trust that we have been able to establish to your complete satisfaction that the tax presently imposed on Sen-Sen—alone of all breath-sweetening products on the market—is (1) discriminatory against us and in favor of nontaxable breath-sweetening products; (2) that the loss of revenue will be negligible and (3) that the removal of this lone item designated as an aromatic cachou, would, in the words of the Acting Secretary of the Treasury Wiggins, "tend to decrease the difficulties of administration."

I wish to thank the committee for giving me the opportunity to present this statement.

Statement of Floyd E. Jacobs, General Counsel for the American Reciprocal Insurance Association

Reciprocal exchanges are taxed on the 1942 Revenue Act as amended in 1950, effective 1951, and in H. R. 4473 subparagraph (a) (3) of section 207. Section 207 related generally to the taxation of mutual insurance companies other than life or marine, and reciprocal exchanges are separately treated in the subparagraph above referred to.

In 1942 the Treasury Department made an independent investigation of reciprocal underwriting for the purpose of taxation, and as a result thereof the foregoing subparagraphs of section 207 of the internal revenue laws were enacted.

Reciprocal exchanges, under section 207, are taxed as such; however, a reciprocal exchange is not an entity, it is a mere place at which subscriber policyholders exchange, one with the other, contracts of indemnity. This is effected through the medium of an attorney in fact who acts under specific written terms of a power of attorney, or subscriber's agreement, signed by each individual subscriber policyholder, such attorney in fact acting specifically under such power of attorney for the subscriber policyholders. The subscriber policyholder at a reciprocal exchange is at once an insured and an insurer. A reciprocal exchange is not an insurer; indeed, it is not an entity and, therefore, cannot and does not own anything. It is a mere place at which the subscribers exchange contracts of indemnity.

There is no joint fund in the hands of the attorney-in-fact for subscribers at a reciprocal exchange. Each subscriber policyholder makes a deposit measured by the normal manual premium rates for the particular kind of fire and casualty insurance involved. This deposit is credited to the specific account of the depositing subscriber policyholder. Title remains in him and such deposit, at no time, becomes part of a joint fund. There is no joint liability on the part of the subscriber policyholder, but he authorizes his attorney-in-fact to pay out of his deposit his proportionate part of losses and expenses, and the remainder constitutes an unused deposit, or saving, to the specific depositing subscriber policyholder.

The subscriber policyholder who is an insurer, pays taxes on the moneys which he deposits and upon any interest earned on that money while in the hands of his attorney-in-fact. When he makes the deposit, if under the statute he is permitted to deduct same from his income-tax return as a reasonable business expense, and the expense of the year does not consume all his deposit so that he has an unused portion, or a saving, he is then required to list such unused portion and the interest earnings on his deposit in his tax return as an additional income.

Under section 207, the Reciprocal Exchange, though a nonentity which owns nothing and can own nothing, pays taxes upon investment earnings. We have no particular quarrel with this provision, although the reciprocal exchange does not own the money and pays taxes on such investment earnings upon which the insurer subscriber policyholder also pays taxes.

Section 207; part II, of H. R. 4473 recently passed by the House of Representatives, after extended hearings before the House Ways and Means Committee was insofar as its essential provisions are concerned, left undisturbed. There was some substitution by the repeal of subparagraphs A and B of section (a) (3) of 207 and in the reenactment of subparagraphs A and B some changes were made with regard to the substitution of percentages in one or two instances instead of references for returns to other sections of the revenue law. In addition thereto, in paragraph A originally, that is in the 1942 revenue act, there was a 48 percent tax rate provided. In the 1950 act, effective 1951, that percentage was raised to 50 percent, and in the present H. R. 4473 was increased to 60 percent.

In paragraph B relating to surtax, the 33 percent referred to therein was increased from 30 percent, as provided in the 1942 act, to 33 percent in the 1950 amendment, and so left in the present law.

Reciprocal underwriting with respect to volume of business is comparatively small. It constitutes only a very small percentage of volume of fire and casualty underwriting in this country. Since the insurers in reciprocal underwriting may be individuals, partnerships, or corporations, that is, the subscriber policyholders, it is technically impossible to tax them as an insuring corporate entity if the general theory of internal revenue taxation is followed, and it is certainly technically illogical to tax a reciprocal exchange, which is not an entity and which owns nothing.

Indeed, it was sufficiently inconsequential that no person making a statement either before the House Ways and Means Committee or thus far before the Senate Committee on Finance has mentioned reciprocal exchanges or their taxation.

This is particularly true, as hereinbefore pointed out, since the individual subscriber policyholders are paying taxes upon exactly the same money and more, upon which reciprocal exchanges are paying taxes; that is, the deposit made by the subscriber policyholder, as it came into the hands of such subscriber, was the subject of income taxation. If the subscriber was an individual then upon rates applicable to individuals, if a corporation then upon corporate rates.

Thus, taxes having been fully paid upon the money which represents a deposit, and then if interest is earned upon same while in the hands of the attorney-in-fact, that interest belongs to the subscriber and the subscriber pays taxes upon the same as well as upon any saving or unused portion of the deposit.

At the same time the reciprocal exchange which does not and could not have any ownership in the money, likewise pays taxes upon interest or investment earnings upon such money.

As stated, however, we have accepted without objection the revenue law as passed in 1942 and as since amended, and we now request that this honorable committee accept section 207 of part II of H. R. 4473.

When the Revenue Act was considered by the Ways and Means Committee it was decided by that committee and accepted by the House that section 207 of the internal revenue law, with the exception of the changes relating to increases in rates heretofore referred to, should be retained in the new H. R. 4473. That since the question of insurance taxation was highly technical the matter of insurance taxation should be and was referred to the staff of the Joint Committee on Internal Revenue for careful study and analysis, such investigation to begin this September. The wisdom of the Congress of the United States in creating the staff of the Joint Committee on Internal Revenue to investigate highly technical matters and reports its findings to Congress has been clearly established by past experience. Indeed, in connection with the passage of appropriation bills the Senate Committee on Expenditures has now, in recognition of the wisdom of creating a body for the investigation of technical matters in behalf of Congress, recommended passage of a bill sponsored by its chairman, Senator McClellan, creating a Joint Committee on the Budget composed of members of the House and Senate Committee on Appropriations and the Committees on Expenditures in the Executive Departments.

This creation would be a counterpart of the Joint Committee on Internal Revenue taxation and is a recognition of the value of the idea which prompted the creation of this latter staff.

Reciprocal subscribers at reciprocal exchanges, through their attorneys-in-fact, have filed a formal statement with the staff of the Joint Committee on Internal Revenue and with the Treasury Department, which is to act in conjunction with the staff in its technical study of insurance taxation beginning in September, a promise of the fullest cooperation.

At such time as the staff of the Joint Committee on Internal Revenue and the Treasury Department deems convenient, all information will be submitted to them concerning reciprocal underwriting.

May we then request, on behalf of subscribers at reciprocal exchanges, that section 207 of part II of H. R. 4473 be accepted by the Senate Committee on Finance pending the technical investigation heretofore referred to, to be begun in September by both the staff of the Joint Committee on Internal Revenue and the Treasury Department?

Senator BYRD. Mr. Hedges.

STATEMENT OF MERTLAND M. HEDGES, PRESIDENT, M. M. HEDGES MANUFACTURING CO., INC.

Mr. HEDGES. I am Mertland M. Hedges, president of the M. M. Hedges Co., of Chattanooga, Tenn., a small manufacturer of automatic water heaters for the home and farm. I have requested a hearing before your committee to recommend that the electric, gas, and oil-fired water heaters of the automatic-storage type be excused from the burden of an excise tax.

Senator KERR. What do you mean by "storage type"?

Mr. HEDGES. It is an insulated tank with automatic controls.

Senator KERR. To heat hot water for the bath?

Mr. HEDGES. Yes.

Senator KERR. I thought you had an——

Mr. HEDGES. It is for your bath, your washing——

Senator KERR. Yes, I know.

Mr. HEDGES. I have filed a brief with the secretary of your committee explaining in detail the reasons for this recommendation. I will not take your time to read this brief since your acting chairman has informed me that you are pressed for time. I appear before you only to present the following short summary and to answer any questions which may arise.

First: The water heater is an integral part and component of household sanitary and plumbing equipment. It is so recognized by the Department of Commerce, FHA, NPA, and the Federal Reserve Board in their regulations on consumer-credit restrictions. It is the source of hot water for personal cleanliness, sanitary food preparation, clothes washing, and the maintenance of health. It is basic for the bath, the shower, the sink, and the laundry. It is as important as the commode or the kitchen sink. It is not an appliance or luxury.

Second: There are two general types of equipment for heating water in the home or on the farm. The old combination of a range boiler with a furnace coil or bucket-a-day stove is inefficient in fuel consumption, unsatisfactory in delivery of water at proper temperature, and hazardous in design. The modern storage type of insulated water heater, fired by electricity, gas or oil, is dependable, safe, efficient, and uses the minimum of critical materials. Yet the range boiler, furnace coil and bucket-a-day stove are not taxed and the automatic type is taxed.

Third: The purchase of water-heating equipment, original or for replacement is mandatory and unavoidable. In new homes a water heater is as basic as wiring, piping, and central heating. A water heater failure necessitates almost without exception, a completely new piece of equipment. No one purchases a new water heater for reasons of obsolescence or appearance-design change any more than they put new pipes in a home until absolutely necessary. It is estimated that replacement requirements alone are now running at over 2½ million units per year.

In conclusion, I submit that an automatic storage-type water heater is a sanitary and plumbing-equipment item. It is the only modern, dependable and safe equipment for heating water and its purchase is unavoidable. Excise taxes are not applied on other plumbing items, not even on an obsolete design of water heater.

I submit, gentlemen, that it is inconsistent to conclude that plumbing equipment in general not be taxed except for the water heater. I further submit that it is not just to levy a tax on a piece of equipment essential to health which must be purchased by home owners without warning or choice. It must be remembered that the large majority of these home owners are in the low-income groups—those least able to pay the tax.

I greatly appreciate the time which you have allowed me and have been very honored to appear before your committee.

Thank you very much.

Senator KERR. Mr. Chairman, I notice he has attached a statement by Mr. Hedges. Do you want all of it in the record?

Mr. HEDGES. Yes, sir. The actual statement—in other words, I consider that first one I just read as a summary of the actual statement.

Senator BYRD. That will be inserted in the record.

(The statement is as follows:)

STATEMENT OF MERTLAND M. HEDGES, PRESIDENT, M. M. HEDGES MANUFACTURING CO., INC., CHATTANOOGA, TENN.

I am Mertland Hedges, president of a small company in Chattanooga, Tenn., making automatic water heaters, used almost entirely in homes and farms. I am a small-business man.

Although I am here to represent our company and its employees, I feel that I speak for the other members of the water-heating industry. There are approximately 120 manufacturers of automatic insulated water heaters scattered throughout the United States. These manufacturers produce almost 3,500,000 automatic water heaters a year. Most of them are also small manufacturers, employing less than 400 people. A tremendous number of small wholesale, retail, installation, and service organizations are dependent wholly or in part on water-heater sales, installation, and service. They are located in every city, town, and village throughout the entire United States.

First, I should like to invite your attention to the several ways in which water can be heated for use in the home or on the farm. Skipping over the obvious means of heating water by a kettle on the stove or a metal pot over a fire, we come to the system where a tank of water, called a range boiler in our trade, is heated by coils or linings in the furnace and other indirect methods. There is no tax on coils or linings or tanks. This system produces hot water during the home-heating season. Sometimes it is too cold, sometimes dangerously hot, and always it is a wasteful and expensive method. But when we combine this tank with a self-contained method of heating and add insulation for efficiency and automatic controls for dependably uniform temperature, then the product becomes subject to a 10-percent excise tax. Thus, there is a tax on the efficient self-contained water heater but no tax on competitive and less-efficient means of heating water.

Few people realize the fuel and labor saved by the automatic insulated water heater. Currently a great deal is being said about the necessity for conserving fuel. It has been definitely established by research laboratories that water-heating systems such as furnace coils and the usual uninsulated range boiler soak up one-seventh of the fuel used. If you use coal as your fuel, one shovel in seven goes to heat water. If you use gas or fuel oil, that same one-seventh of your fuel goes to heat water under this obsolete and inefficient system.

The automatic insulated water heater is far more efficient and uses much less fuel. It is thoroughly insulated. It is designed to put the maximum amount of generated heat into the water and hold it there.

There is another great conservation angle to the automatic water heater. That angle is the time and labor saved. One of our industry's slogans is that you can install an automatic water heater and forget it. It will provide water at just the right temperature at the turn of the faucet at any hour of the day or night.

If you do not have an automatic system for heating water and maintaining it at the proper temperature, you waste a lot of time, fuel, and labor. For example, consider a farmer who must have hot water in his dairy barn in order to produce sanitary milk. To get the required hot water he has to fire up a boiler or monkey stove, fuel it, clean it, and waste a lot of time every day. Even then the water may be too hot or too cold for efficient use. Or picture the mother who needs hot water to keep her baby clean and healthy. If she has a monkey stove in the basement, it means constant trips up and down stairs, dust, soot, ashes, cleaning the basement and herself in addition to cleaning the baby. And again she will get water that is too hot or too cold, seldom just right.

Thus, it is our viewpoint, and I believe that you can readily agree, that providing adequate hot water of dependably uniform temperature is an American necessity. It has become as much a part of American sanitary plumbing as the water pipe which brings in clean water, the toilet, wash bowl, tub, shower, or sink, or the soil pipe which takes waste water away.

There is no excise tax on water pipe, no excise tax on toilets or wash bowls, no excise tax on tubs, shower, sink, or soil pipe. The only part of our basic plumbing and sanitary system which bears an excise tax is the automatic water heater. If you heat water for your home in a wasteful, inefficient, and unstable manner through a furnace coil and range boiler there is no excise tax. But when you add efficiency, economy, convenience, and 24-hour-a-day dependable uniformity of temperature, you have a product which is taxed. From our viewpoint, this is inequitable.

Excise taxes appear to have been applied to automatic water heaters because they were, for tax purposes, considered to be appliances. There are several compelling reasons why water heaters should not be classed as appliances for tax purposes.

On this point, please consider the fact that it is a normal custom, in selling a home, for the seller to remove his furnishings and appliance, but his water heater is considered an integral part of the plumbing and is not removed.

Many divisions of our National Government have agreed with the viewpoint which I am presenting on behalf of small-business men.

The Department of Commerce, Bureau of the Census, publishes statistical facts for industry. These statistical facts are presented by product groups. In this Department of Commerce compilation of figures, water heaters are not grouped with appliances. Water heaters are grouped with range boilers and hot-water-storage tanks, which are competitive but untaxed ways to heat water. We submit that this is the proper grouping.

Regulation W was enacted by the Federal Reserve Board to control credit terms. Regulation W applies to appliances. It does not apply to water heaters. We submit this fact as further evidence that water heaters are a necessary part of our sanitary system and not an appliance.

Under the Defense Production Act which you gentlemen passed in 1950, the National Production Authority, through its controlled-materials plan, has allocated scarce materials. Under this plan, materials for appliances have been cut back but materials for water heaters have been specifically provided. Again, this is an example of Federal recognition of the fact that the water heater is a basic plumbing and sanitary essential and not an appliance.

One of the purposes of the excise tax is sometimes stated as a measure for controlling the consumption of critical materials in short supply. Since materials for water heaters are provided under CMP, it is evident that the excise tax on water heaters cannot properly be defended on the basis of controlling the consumption of materials.

Another stated purpose of the excise tax is to reduce the consumption of "those consumer goods which are less essential or are classified as luxuries." It is estimated that for necessary replacement alone, 2½ million units will be required this year.

As further emphasis on the point of basic necessity, I suggest that we consider briefly some of the uses of water heaters.

Many States have laws which require that adequate hot water be available at all times for employees handling food. This law has caused the installation of water heaters in countless small food businesses, including lunch stands, restaurants, and grocery stores. Hot water is thus, by law, a necessity.

Hot water is virtually a necessity for every farm. Milking, for example, under accepted sanitary codes, requires hot water of a dependably even temperature. That is one reason why so many water heaters are being installed on American farms. If this Nation is to have the abundant and clean, safe food it requires, then tools must be made available to our farmers with minimum handicap of discriminatory excise taxes applied to their working tools. Definitely, the modern farmer knows that a water heater is a necessary tool in his business.

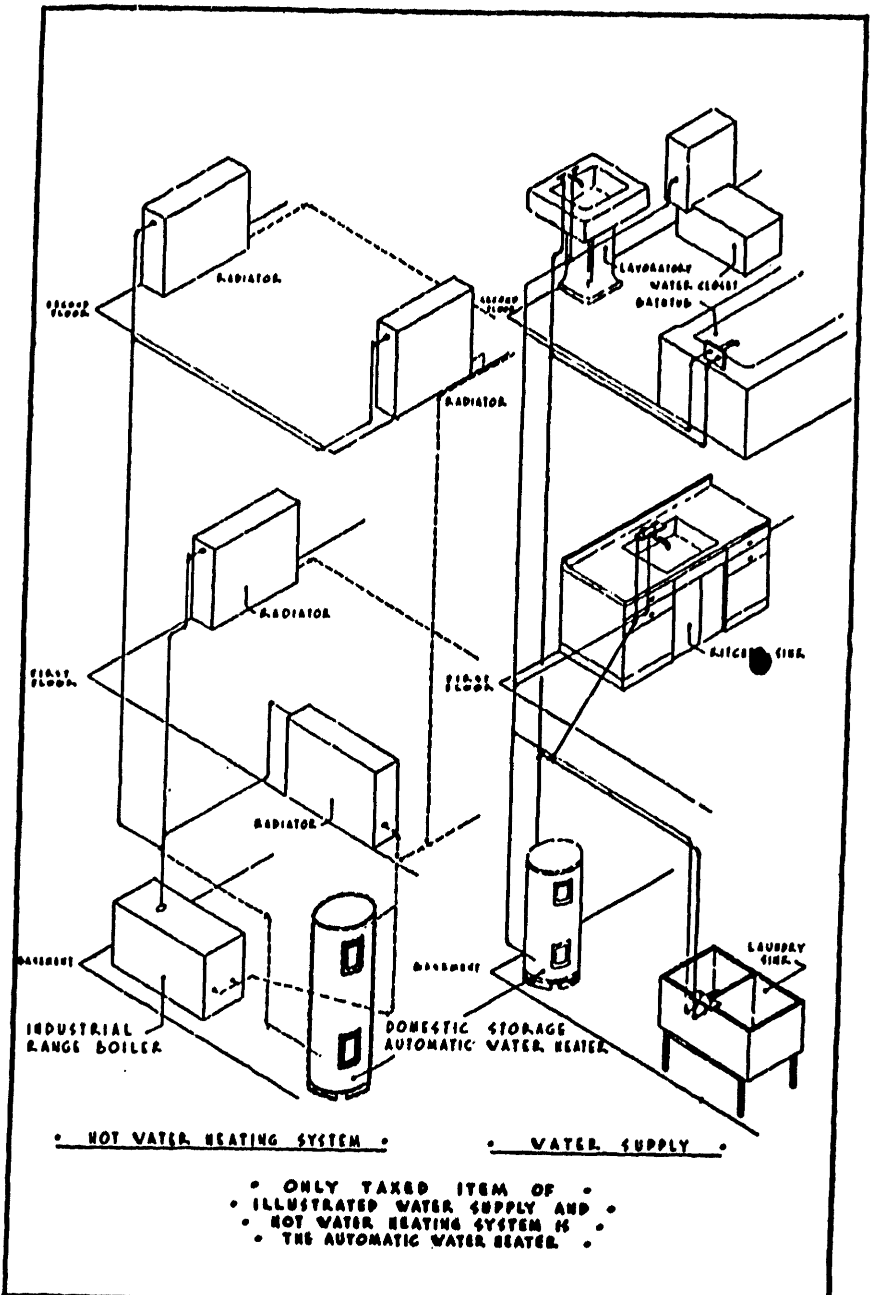
And if you gentlemen still do not agree that water heaters are a basic household necessity, I beg that you will individually assume for 24 hours the care of a home with small children in it. The mothers of America have of necessity learned to do without many things. But every mother will place the water heater high up on her list of absolute basic necessities.

And have any of you gentlemen faced sickness or accident in a place where hot water was not available? Have you ever had sickness in your family in the small hours of the night and found no hot water available? Yet the excise tax on water heaters bears most brutally on our low-income families. Our low-income families have the largest number of children, the greatest need for water heaters. The excise tax withholds this basic necessity from lower-income families.

You gentlemen have provided special consideration for mothers and farmers in many bills. Taxes on baby powder and baby oils have been withdrawn. It seems evident that hot water is a necessary tool for farmers * * * and certainly is a basic necessity for healthy and happy babies.

I hope that these thoughts which I present as a representative of a considerable group of small-business men will lead you to agree with us that water heaters are a basic part of our American plumbing and sanitary system and thus not within the scope of the excise tax.

Please see next page for schematic drawing for typical plumbing arrangements in the home.



Senator BYRD. Mr. Muhlbach, of the Institute of Cooking and Heating Appliances.

STATEMENT OF WALTER F. MUHLBACH, PRESIDENT, THE INSTITUTE OF COOKING AND HEATING APPLIANCE MANUFACTURERS

Mr. MUHLBACH. Mr. Chairman, in accordance with your request, Mr. E. A. Lindemann, who was scheduled to follow me as president of the A. J. Lindemann & Hoverson Co., will not present his brief, nor will I read the brief that we have prepared.

Senator BYRD. Do you have Mr. Lindemann's brief to include in the record?

Mr. MUHLBACH. Yes, sir; it is available here.

Senator BYRD. All right, sir.

Mr. MUHLBACH. My name is Walter F. Muhlbach. I speak on behalf of approximately 150 manufacturing members of the Institute of Cooking and Heating Appliance Manufacturers, of which I am president and of which my company is a member.

In 1942 a 10 percent excise tax was placed on cooking stoves, using oil, gas, and electricity as a fuel, and on water-heaters.

That was an emergency tax designed primarily to restrict the manufacture of these appliances.

The Secretary of the Treasury, Mr. Snyder, has recommended an increase from 20 to 25 percent. We are appearing, not only to protest the increase, but to request a repeal of the original 10 percent tax.

Now, without going into detail, the details which we have included in the brief, I would like to show you, and ask your attention to a chart which I have supplied the members of the committee in smaller form.

This chart presents sales of all types of stoves in 1950. The straight line is the average monthly sales in 1937, a year in which there was an amount of unemployment, of about 5 million. The solid black line represents the monthly sales of 1951.

Now, the most startling thing about that chart as a whole is not the fact that what has happened in 1951 is that sales are below the level of the depression years, but what I consider the most important aspect of this chart—I am not a magician, but if you will look at this chart with your mind as well as your eye, this line will appear to be below this one because, keep in mind, there are over 10 million more families today than there were in 1937.

The disposable income has gone up nearly three times what it was in 1937.

Senator KERR. What is the total number of family units today?

Mr. MUHLBACH. Between 44 million and 43 million. There were a little over 33 million in 1937.

Senator KERR. What is the source of that information?

Mr. MUHLBACH. The Census Bureau.

Senator KERR. 44 million today?

Mr. MUHLBACH. Yes, sir.

Senator KERR. 33 million in 1937?

Mr. MUHLBACH. That is right. 33,285,000 in 1937, 43,468,000 in 1950, an increase of somewhat over 30 percent.

Senator KERR. In 13 years?

Mr. MUHLBACH. Yes. Disposable personal income has gone up from a little over 71 billion to over 204 billion.

In 1937 there were 336,000 homes, nonfarm dwelling units built. In 1950 there were over a million more, 1,396,000. The number of homes constructed in 1950 was more than four times the number constructed in 1937.

The number of stoves of all kinds sold in 1950 was only 25 per cent higher than in 1937.

Senator KERR. How do you account for that?

Mr. MUHLBACH. There are a number of reasons for it, but we are convinced that one of the major reasons is the fact that stoves are now, for reasons beyond our control, considerably more expensive than they were in 1937.

The average gas range in 1937 had a retail value of approximately $75. The average price today is about $150.

Senator KERR. All these homes have something in them that they cook with, do they not?

Mr. MUHLBACH. That is right, but stoves wear out and stoves are improved.

The average stove today is a much different type of cooking appliance than it was even 10 years ago.

Senator KERR. What I am trying to figure out is how 1,433,000 family units built in 1950——

Mr. MUHLBACH. That is right.

Senator KERR. How many stoves were sold?

Mr. MUHLBACH. There were a total of 5,000,000 stoves sold in 1950, because the largest market for stoves is the replacement market; stoves wear out, they become obsolete. We estimate that the average gas range has a usable life of approximately 15 years. If a stove is used beyond its life it introduces a hazard.

Senator KERR. Now, if there are 44 million units and you sell 5 million, that is 11 percent—that is about a 9-year life.

You have the problem of a million and a half of them in new homes.

Mr. MUHLBACH. Yes, sir. Also there has been a definite trend away from the old coal and wood stove, which is no longer usable in many types of homes. The Government itself has tried to encourage through REA the substitution of electric ranges for coal.

Senator KERR. These figures you represent to us do not include the electric stoves?

Mr. MUHLBACH. These are stoves of all fuels—electricity, gas, wood, coal, and oil.

Gentlemen, Sunday I passed with my family through the little town of Plymouth, Mass. We stopped to examine a reproduction of one of the first homes built by the Pilgrims.

I was interested in observing nothing in that home that was not absolutely essential, but basically there were only two items in that home.

There was a bed on which the householder rested after working to produce or to find his food, and a place in which that food could be prepared.

Those are the two essential items.

Today the bed is not taxed, but the stove is.

Senator BYRD. It is not a new tax, is it?

Mr. MUHLBACH. This is a tax that has been in existence since 1942.

The first kitchen I recall, my mother's kitchen, had no kitchen sink. It had no water heater. It had a table and a cupboard and a stove. There is nothing, we submit, more essential, than the cooking stove in the kitchen. In fact, there is no reason for a kitchen unless you plan to prepare food in it. The stove is the most essential of any household appliance, and that is one of the few items that are subject to excise tax. You do not tax the food, but you do tax the stove.

It appears to us entirely illogical. The tax is discriminatory. We are not today helping the average American maintain the same standard of living that he enjoyed in 1937.

We are not replacing the stoves in use that are now over-age at the rate that we were producing and replacing during the latter half of the depression of the thirties.

We urge, as strongly as we know how, that you not only do not increase the tax on stoves, but that you repeal the present tax and if you find it necessary to continue a consumption tax, that you place a tax on all products on an equal basis.

Thank you very much.

Senator BYRD. Thank you very much, sir.

(The statements of Mr. Muhlbach and Mr. Lindemann are as follows:)

STATEMENT BY WALTER F. MUHLBACH, PRESIDENT, THE INSTITUTE OF COOKING AND HEATING APPLIANCE MANUFACTURERS, AND DIRECTOR, DISTRIBUTION AND RESEARCH, THE FLORENCE STOVE CO., GARDNER, MASS., REPRESENTING PRODUCERS OF ELECTRIC, GAS, AND OIL COOKING AND WATER HEATING APPLIANCES

Mr. Chairman and members of the Finance Committee, my name is Walter F. Muhlbach and I speak on behalf of the approximately 150 manufacturing members of the Institute of Cooking and Heating Appliance Manufacturers, of which I am president, and of which my company, the Florence Stove Co., is a member.

The manufacturers in the institute produce electric, gas, and oil appliances for cooking and water-heating purposes. These appliances are currently subject to a 10-percent excise tax under section 3406 (a) (3) of the Internal Revenue Code. Secretary of the Treasury John W. Snyder, in his statement before the House Ways and Means Committee on February 5 of this year, recommended, among other things, that the tax on these appliances be raised from 10 percent to 25 percent of the manufacturer's selling price, a raise of 150 percent. The House, recognizing the fallacy of this discriminatory tax on a prime necessity of life, refused to increase the 10-percent rate, but did not recommend the complete repeal of the tax, which we urgently request your committee to do.

The trade association for which I speak represents about 80 percent of the productive capacity of the cooking and water-heating-appliance industry in the United States. This industry operates in 28 States and employs over 100,000 persons. The sale of our products also gives work to a tremendous number of employees in an estimated 5,000 distributor and 85,000 dealer establishments. For the most part the industry is made up of small individual enterprises employing less than 500 persons.

It is grossly unfair to the American public and to the manufacturers of the most essential of all household appliances to impose even a 10-percent tax on gas-, electric-, and oil-cooking appliances and water heaters, and immeasurably worse to consider increasing that tax.

Briefly our position is this:

1. Cooking ranges and water heaters are the most essential of all household appliances. A tax on them is in effect a tax on food and bodily comfort, a tax which no Congress can afford to impose.

1. The tax is discriminatory because it does not apply equally to all kinds of consumer goods. Both durable and nondurable goods are in competition with each other. When Congress imposes an exorbitant tax on the purchase of one commodity and fails to tax all other consumer goods, it is not necessarily restricting the total of consumer purchases. It is simply diverting the purchase from one type of product to another, perhaps less essential. You will not have aided the fight against inflation, nor helped to solve the fiscal problem of the Government, since a substantial part of the planned purchases of taxed items will merely be diverted to the purchase of untaxed items.

3. The suggestion made by Secretary Snyder that excise taxes could be used as a weapon for conserving materials is improper. Material conservation is now

effectively handled through NPA orders and is not a function of tax legislation nor does his proposal give due consideration to the relative essentiality of various products.

4. Secretary Snyder has estimated that $425,000,000 in additional revenue would be derived from the tax which he proposes on consumer durable goods. We question the accuracy of that estimate for two basic reasons:

> First, NPA curtailment orders already issued have restricted production of these items at least 35 percent from recent levels, with sharper cut-backs still to come, and
>
> Second, the high rate of the tax after it is pyramided in the channels of distribution, has proved a distinct sales deterrent and will, in my opinion, further reduce sales of the taxed items.

5. The discriminatory nature of the proposed tax will disrupt competitive conditions in the affected industries and threaten employment and business solvency. Congress in passing the Defense Production Act of 1950 wisely took precautions to avoid, as far as possible, a defense-mobilization program which would unnecessarily or arbitrarily convert the American system into a planned economy. Rather, you specifically charged the defense agencies with the responsibility of giving consideration to the needs of business, particularly of small business, and of the civilian economy.

6. The excise tax has drastically restricted the American people from acquiring cooking stoves at a rate sufficient to maintain even the standard of living which prevailed in the depression period of the late thirties.

A brief examination of the attached chart will indicate the sharp decline in cooking-stove sales in recent months—a decline much greater than planned by the National Production Authority when controls on scarce metals were imposed. Although stove sales in 1950 appear greater than in the prewar period, actually they were lower in relation to the needs of the American consumer when you remember that the number of homes has increased more than 30 percent, general standards of living have risen sharply, and financial ability to buy is greater than in the late thirties when we still had a high degree of unemployment.

7. The postponement of the purchase of a new cooking range or water heater to replace a worn-out appliance may result in actual hazard to health and property.

8. Even veterans' and Government-subsidized military housing projects are burdened by this tax.

9. The cost to the public of a pyramided manufacturer's tax is prohibitive. Tax authorities agree that any tax is bad if it bears most heavily on those least able to pay, or if the cost to the taxpayer is out of proportion to the net return to the Government. In our presentation to congressional committees last year, we pointed out that the consumer in 1949 paid approximately $86 million as a result of the excise tax on gas, electric, and oil appliances, although the Government received only $50 million in revenue. In other words, consumers paid approximately 72 percent more than the Government collected.

No excise tax should ever have been imposed on cooking ranges and water heaters. They are essential to life and bodily comfort. They are not luxuries. We therefore again request the repeal of section 3406 (a) (3).

Our positive proposals to meet the temporary emergency fiscal needs of the Government include:

1. That an emergency tax be imposed at the lowest possible rate on all manufactured consumer goods, except food and medicine. This emergency tax could be in addition to excise taxes, which have traditionally been imposed on such products as alcohol and tobacco.

2. That this emergency tax be imposed on a year-to-year basis so that Congress will have an opportunity to reconsider the amount of revenue needed for each fiscal year. It will thus be possible for Congress to permit the tax to expire at the end of any fiscal year when the tax revenue is no longer urgently needed.

The tax on cooking- and water-heating appliances imposed in 1941 as a conservation measure on scarce metals, continued in a postwar period when production should have been encouraged, not discouraged. The same mistake must not be made again. The House's repeal action last year recognized the validity of that statement.

3. That the need for increased revenue be held to an absolute minimum by careful study of the Federal budget to effect all possible savings and by more widespread adoption of the efficiency and economy measures proposed in the report of the Hoover Commission. All items in the nondefense budget not essential to the times should be eliminated and all extravagances taken out of

the military appropriations so long as the economies do not affect the strength of our military machine.

By substituting an emergency tax on all manufactured consumer goods, for the present selective and discriminatory excise tax, the Government will be able to collect the $3 billion in additional revenue which the administration says is required, and at the same time spread the burden more broadly and more equitably. If Congress should determine that the emergency tax be imposed at the manufacturing level rather than at the retail level a specific provision should be written into the law that the tax must be passed along without mark-up so that the consumer will be paying only the exact amount of the tax collected by the Government.

In conclusion and summary, we request that the present excise tax on gas, electric, and oil appliances be repealed, and the needed revenue be raised by an emergency tax on all manufactured consumer goods, except food and medicine, at the lowest possible rate.

We have appreciated this opportunity to present our case to you again and shall be glad to supplement this brief either by answering questions from committee members or by submitting further written statements upon request.

STATEMENT BY EUGENE A. LINDEMANN, PRESIDENT, A. J. LINDEMANN & HOVERSON CO.

Mr. Chairman and members of the Finance Committee, my name is Eugene A. Lindemann, and I am president of the A. J. Lindemann & Hoverson Co., of Milwaukee, manufacturers and sellers of electric ranges, electric water heaters, kerosene stoves and ranges, household refrigerators, and freezers.

On February 20, 1950, I appeared before the House Ways and Means Committee to urge the repeal of the 10 percent manufacturer's excise tax, particularly as it, at that time, related to cook stoves and water heaters. The arguments given in favor of repeal then are still valid arguments, and they are made in detail on page 1838 of the record of the proceedings of the Ways and Means Committee in those hearings.

At that time also I was supported in my arguments by local No. 330 of the UAW-CIO, whose supporting letter is also in the record.

We and many of our associates in the industry are unalterably opposed to excise taxes on our products, and will continue to be so opposed. Our contention was upheld by vote of the House of Representatives which voted to repeal these taxes last year, but the outbreak of war in Korea caused the Senate to drop its consideration of the repeal measure.

Knowing the state of the Nation, and the emergency confronting us, we now believe that an emergency tax should be substituted for the present excise tax. This emergency tax should have the following features:

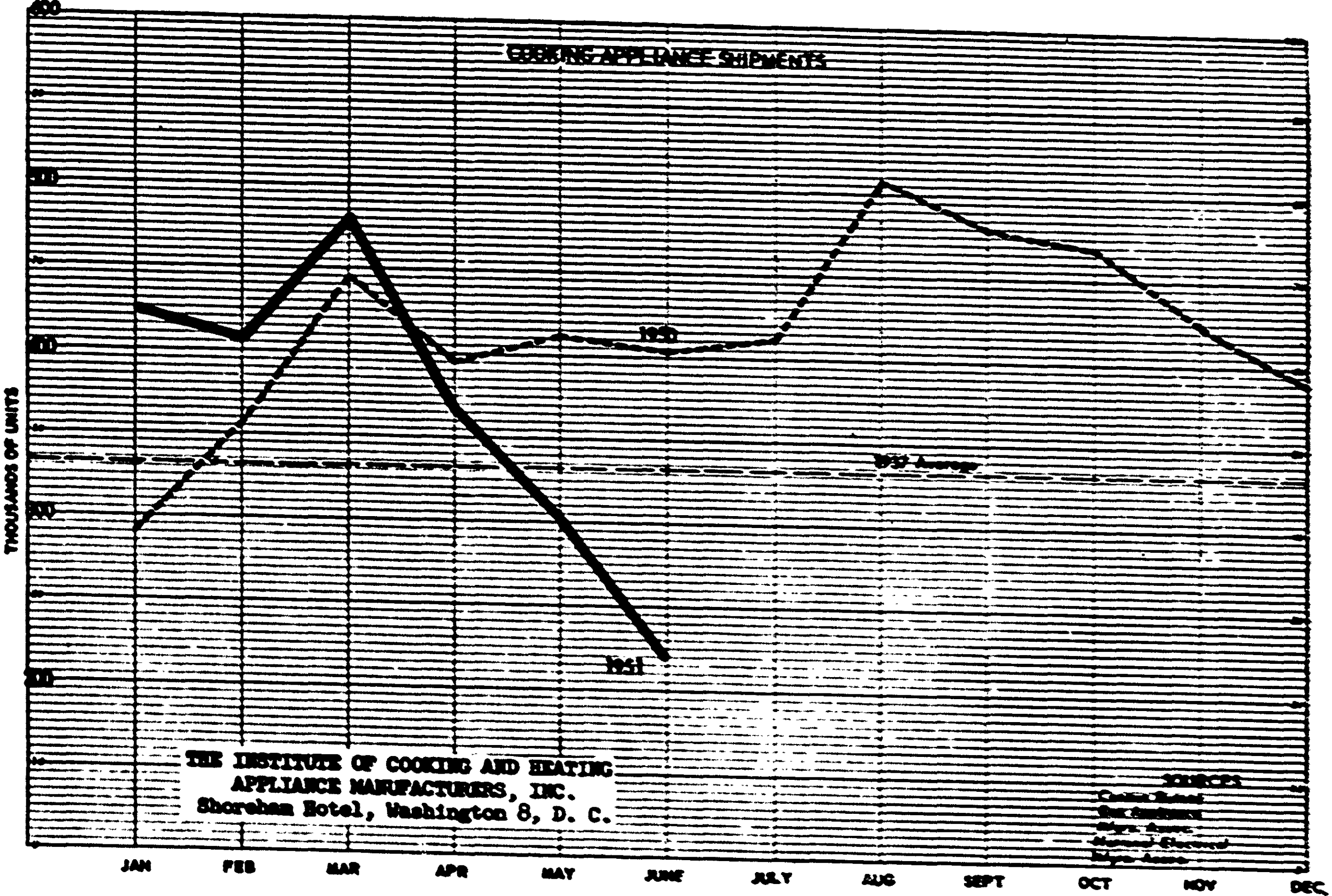
1. It should have a definite limitation of term for a stated time—say 1 or 2 years—and should not be automatically renewable except by action of Congress at the expiration of that term.

2. Since the practice in the industry has been for distributors and dealers to pyramid these taxes, the consumer pays an added cost for the product far greater than the Government collects in taxes—sometimes as much as 100 percent more. The tax should be carried forward in dollar amount, and the percentages of overheads of the dealers and distributors should not be allowed to be applicable on the amount of the tax. This will serve two purposes: (*a*) to keep the cost of the appliance lower; and (*b*) as a deterrent to inflation.

3. The general base of this type of emergency tax should be broadened to include such manufactured consumer items as are not presently under excise taxes. To do otherwise would be to continue the discriminatory feature of this tax against this industry and this line of products.

I have had conversations with the executives of the union in our shop, and they agree wholeheartedly with the above outline, just as they previously agreed with the testimony given before the House Ways and Means Committee a year ago. The members of the union feel that to have a tax as high as the one proposed will in the future be seriously detrimental to their jobs, and I agree with that thought. It will also be detrimental to our own business, since the tax in the amount proposed would raise the prices of our products so high above those of other household items that the purchase of ours would be deferred in favor of appliances which might not be so expensive.

Thank you for giving me this privilege of presenting my views to the committee.


COOKING APPLIANCE SHIPMENTS
THOUSANDS OF UNITS
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DEC.
THE INSTITUTE OF COOKING AND HEATING
APPLIANCE MANUFACTURERS, INC.
Shoreham Hotel, Washington 8, D. C.
SOURCES

Senator BYRD. The Chair inserts in the record at this point numerous statements in lieu of personal appearances.

(The statements are as follows:)

STATEMENT OF RALPH W. BUTTON, OF THE NATIONAL RETAIL DRY GOODS ASSOCIATION

This statement is submitted by Ralph W. Button, assistant secretary, Allied Stores Corp., and chairman of the taxation committee of the National Retail Dry Goods Association. The National Retail Dry Goods Association is a voluntary organization that is registered under the Lobbying Act. The association's registered agent in Washington is John C. Hazen. The National Retail Dry Goods Association is composed of approximately 7,000 department and specialty stores throughout the United States. The annual sales of the members of this association exceed $10 billion.

We are addressing ourselves in this paper to the question of excise taxes and the part they should play in our tax structure at the present time.

The N. R. D. G. A. and retailing generally have historically taken a stand in opposition to any and all taxes on consumption. The argument that these taxes are regressive and fall more harshly on the lower-income groups needs little amplification.

The introduction of selective excise taxes in our revenue system is based solely on the need for revenue without regard to the economic effect of such taxes on the producers of the products so taxed or the workers engaged in those taxed industries. The inequities of selective excise taxes ought to be apparent. The arguments against discriminatory excise taxation has been previously brought to the attention of this committee last year and needs no enlargement at this time.

Arguments have been heard that selective excise taxes prevent the use in civilian production of materials needed for the military effort. We do not believe that this is the proper way to deal with this problem. Curtailment of the manufacture of certain products, if necessary, because materials are needed for the military effort should be left to those agencies which are now in existence and have the required authority to allocate materials. We are certain that in this way ample protection will be given to all necessary military requirements.

What selective excises accomplish in great part is not the curtailment of manufactured products which are required by the military, but rather the elimination of the small-income earner as a potential customer. It seems to us inequitable that the product should be available to only those people who can pay higher prices. Rationing should not be something for the poor alone. The N. R. D. G. A. has from time to time departed from its opposition to excise taxes because it felt that in a wartime economy there was no alternative but to use every avenue available for the raising of the huge sums of money necessary to meet both our domestic and military requirements.

Retailers have approached the problem of raising revenue on the premise of what's good for the country is good for retailing. We recognize that the great need for revenue requires the use of some form of excise taxes. We have accordingly supported the imposition of excise taxes to a limited number of items.

We have stated in our testimony before this committee, that if Congress broadens the base of the present manufacturers' excise taxes and the retailers' excise to such an extent that they amount to a national manufacturers' excise tax then we would advocate the enactment of a national retail sales tax.

Your committee has heard many arguments for and against a broad manufacturers' excise tax and for and against a national retail sales tax.

The proponents of broad manufacturers' excise tax have presented the following arguments:

1. A manufacturers' excise tax is easier to administer since there are a smaller number of manufacturers than there are retailers.

It is admitted that there are a greater number of retailers than manufacturers. We are not ready to admit that this problem of administration is an insurmountable obstacle. Every person, firm, or company engaged in the business of selling merchandise is required to file an income-tax return. It would be a very simple matter to provide for a schedule in such income-tax returns showing total sales and the amount of tax collected. This would provide a simple check on the sales tax collected and paid over to the Government.

2. It is stated by the proponents that pyramiding is not likely to be very substantial and Canada's experience is used as an illustration.

We are not familiar with Canada's tax laws. But we do know that a manufacturers' excise tax is as much a part of the cost of merchandise as any other element of cost. To the extent that a margin of profit is figured on cost then to that extent there is pyramiding involved. Belittling this importance of pyramiding is being naive indeed.

8. Twenty-nine States and a number of cities now have retail sales taxes and it is said that the National Government should not impose an additional sales tax on top thereof.

This does not appear to be a valid argument. Thirty States and a number of cities impose income taxes. Should not the Federal income tax on individuals be repealed for this same reason.

Overlapping of revenue sources by Federal, State, and local governments is a problem of long standing. Many studies have been made and no satisfactory solution has been found.

The Federal revenue needs must be given first preference in this hour of emergency. Determination of the spheres of taxation should be left to a more propitious time.

One argument against a broad manufacturers' excise tax which should receive serious consideration is the effect that such a tax has on the cost of living. A manufacturer's excise tax will be taken into account in the compilation of cost-of-living indexes. There are many wage agreements which provide for increases in wages based on the cost-of-living index. This means then that a broad manufacturers' excise tax will result in demands for salary and wage boosts thus increasing inflationary pressures. Such salary and wage demands will not be limited to wage agreements but will spill over into the entire wage structure. A national retail sales tax does not have this effect.

Retailers, in advocating a national retail sales tax in lieu of a broad manufacturers' excise tax, do so with the full knowledge that they are taking on additional burdens and increasing their costs of doing business. They will be taking on the job of the tax collector. We do this because we sincerely believe that our economy and our people will be better off in the long run.

One of the underlying reasons against a national retail sales tax is that such a tax is politically unpopular. We are in an emergency period. I have faith and confidence that our people would accept a national retail sales tax in lieu of a broad manufacturers' excise tax if the facts of the problem were laid before them in a straight-forward manner.

CENTRAL PREMIX CONCRETE CO.,
Spokane, Wash., July 25, 1951.

Senator HARRY P. CAIN,
Senate Office Building, Washington, D. C.

DEAR SENATOR CAIN: It comes to our attention that in the hearings on the new tax bill now before the Senate Finance Committee that the matter of percentage depletion for sand and gravel deposits is being considered.

You probably know that the House Ways and Means Committee and the House of Representatives have approved a 5-percent depletion for sand and gravel. Similarly a year ago such a provision was in the tax bill passed by both the Senate and House, but which was revised when the Korean War started.

I believe it is well established that the theory of percentage depletion for industries with wasting assets is for the national good.

You may not understand why percentage depletion is necessary for the sand and gravel industry both Nation-wide and more particularly in the Pacific Northwest.

Our industry obviously is basic in all construction. Vast quantities of it are necessary, and it is produced by a large number of producers, most of whom are small. These producers must meet varied specifications of Federal, State, county, and municipal governments. These specifications are not static but constantly changing. A deposit being used today may have to be abandoned tomorrow because of a change in specification.

One of the greatest obstacles facing our industry today is that of zoning restrictions. Sand and gravel plants are objectionable when near residential areas and hence are zoned out of many areas which, of course, are the areas near the potential market. Sand and gravel is a low-cost product. Generally the cost of transportation exceeds the selling price f. o. b. plant. It is thus important that deposits be found as close as possible to the point of use.

In most areas of the United States and certainly in the Spokane area known reserves of commercially usable sand and gravel are too low. Yet the cost of exploring and developing new deposits is extremely high—too expensive for the ordinary small producer unless he would have the assistance of percentage depletion.

To assure a continuing supply of sand and gravel at a reasonable price to the national economy it is essential that our products be given the same consideration given others with wasting assets. We hope we can count on your support.

Very truly yours,

CENTRAL PREMIX CONCRETE CO.,
H. D. SULLIVAN, *President.*

RECOMMENDATIONS FOR MODIFICATION OF THE INTERNAL REVENUE CODE

(Submitted by the Committee on Federal Taxation of the New York State Society of Certified Public Accountants)

1. Annuities

Need for change.—Under section 22 (b) (2), Internal Revenue Code a taxpayer receiving an annuity is taxed on an amount equal to 3 percent of the cost, the remainder being treated as a recovery of capital. In the case of an annuitant well advanced in age when the annuity payments commence, the chance of his recovering his capital tax-free during his lifetime is therefore remote.

Recommendation.—Section 22 (b) (2), Internal Revenue Code should be amended to provide that the principal of the annuity payments shall be computed by spreading the cost of the annuity over the life expectancy beginning with the commencement of the annuity payments, and only that portion of each annuity payment which is in excess of that applicable to principal shall be included in gross income.

2. Time for replacement of involuntary liquidations of LIFO inventories

Need for change.—Section 22 (d) (6) (A), Internal Revenue Code contains the requirement that involuntary liquidations of LIFO inventories which occurred in taxable years 1947 or prior must be replaced in a taxable year which ends prior to January 1, 1953, while such liquidations in a taxable year ended after June 30, 1950, and prior to January 1, 1954, may be replaced in a taxable year ending prior to January 1, 1956. Since partial replacements are considered, in the order of acquisition, as replacements of the most recent liquidations, taxpayers which have not at some time completely replaced their pre-1948 liquidations get no benefit from the additional 3 years permitted for replacement of 1950-53 liquidations.

Recommendation.—Section 22 (d) (6) (A), Internal Revenue Code should be amended to provide that replacements of pre-1948 liquidations should be permitted at least until 1955.

3. Pension trust for professionals and other self-employed individuals

Need for change.—Sections 23 (p) and 165 Internal Revenue Code made no provision for pension trusts for self-employed professional and other individuals, with an obvious resulting discrimination against such classes of taxpayers, who are as much entitled to invoke the application of these provisions as employees of the various business groups.

Recommendation.—The principle of the Keogh bill, H. R. 4371, the Reed bill, H. R. 4373, and the Coudert bill, H. R. 3456, should be enacted with the following limitations:

(1) A self-employed professional person employing nominal or no capital should have his entire net professional income for the year as the measure of the 15 percent of net professional income that may be contributed for that year to the pension trust. As provided in the bills, professional employees should also be permitted to contribute to such pension trusts to supplement their old-age benefits.

(2) The situation of sole proprietors and members of firms employing more than nominal capital is already provided for in the said bills.

4. Payments into nonexempt pension trust

Need for change.—If a pension trust does not qualify under section 165, an employer's contribution thereto is not deductible unless the rights of the employee are nonforfeitable at the time the amount is paid. The regulations hold that, if the employee's right become nonforfeitable subsequent to the making of the contribution, no deduction for such payment is allowable at any time. This places the employer who funds his nonexempt plan with a trustee at a disadvantage compared with the employer who simply retains complete control of the funds involved in a nonexempt plan, since the latter is allowed a deduction under section 23 (p) (1) (D) when the benefits are paid out or the employee's rights otherwise become nonforfeitable.

Recommendation.—Section 23 (p) (1) (D) should be amended to permit the employer making a contribution to a nonexempt pension trust, in which the employee's rights are forfeitable at the time the contribution is made, to deduct such amounts as are income to the employee, in the year in which the employee is required to include such amounts as income.

5. Rates of normal depreciation

Need for change.—Minor changes in depreciation rates under section 23 (l), Internal Revenue Code, have been an administrative problem for many years, causing unnecessary controversy between taxpayers and the Bureau of Internal Revenue at a substantial cost to both. At best, an estimate results and in the long run no appreciable increase in revenue is derived by the changes since deductions are merely shifted between years.

Recommendation.—Rates of normal depreciation for as many classes of fixed assets as possible should be published and taxpayers permitted to make a binding election of depreciation rates as to such classes of assets within 25 percent, either way, of the published rates. In other cases, such as claims for depreciation rates more than 25 percent in excess of published rates, or for additional depreciation for obsolescence or abnormal usage, or for depreciation on classes of assets not included in the published list, the burden of proof should remain on the taxpayer, as at present.

6. Gain or loss to creditor on mortgage foreclosures

Need for change.—Where a creditor buys in mortgaged or pledged property, his loss or gain is measured by the difference between the amount of the obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent income of the creditor) and the fair market value of the property. Section 29.23 (k) (3) of regulations 111 states that the creditor may thereby have a bad debt as well as a capital gain or loss and that "the fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary." The bid price is often no indication of the fair market value and the rule may be used to the disadvantage of either the taxpayer or the Government.

Recommendation.—The code should be amended to provide that where a creditor buys in mortgaged or pledged property, his income or deduction shall be the difference between the obligations of the debtor and the fair market value of the property; that the price for which it is bid in by the creditor shall be disregarded for this purpose; and that the income or deduction shall be ordinary income or deduction (i. e., not capital gain or loss).

7. Methods of accounting

Need for change.—Many of the recognized accounting principles have been gradually adopted by Congress, the Treasury Department, and the courts. In the interests of sound economy more of these principles should be adopted, and where court decisions are in conflict with these principles, this should be corrected by the Congress.

Recommendation.—Sections 23, 41, 42, and 43 of the Internal Revenue Code should embody recognized accounting principles or practices.

In relation to income, only income attributable to a particular taxable period under recognized accounting principles should be taxed in that period. If income covers more than one taxable period it should be properly apportioned over the periods to which it is attributable. A taxpayer, whether on a cash basis or accrual basis, should be permitted to account for rents and other income received in advance over the period to which the payment applies, provided he keeps books of account clearly reflecting the income on such basis.

Correlatively, deductions should be allowed so that they are matched against the related income.

Where income is received involving an obligation to perform services or incur costs and expenses in the future, the taxpayer on the accrual basis should be permitted to set up a reasonable reserve in accordance with recognized accounting principles to cover services and expenses related to such income. Likewise, there should be allowed as deductions, reasonable reserves for costs and expenses to make good warranties and guaranties and for customers' discounts. These reserves should be permitted only if the taxpayer keeps books of account clearly reflecting such deductions.

Where income is deferred to later years, or a reserve or accrual is deducted, the taxpayer should, however, be required to increase the income of the subsequent years for the deferred income applicable thereto, and for reserves and accruals no longer required.

8. Expenses payable to related interests

Need for change.—Section 24 (c), Internal Revenue Code, disallows to a taxpayer on the accrual basis all deductions for unpaid expenses and interest which are payable to related interests who are on a cash basis unless the payment is made during the taxpayer's taxable year or within 2½ months after the close of such year. The purpose of this section is to prevent a taxpayer claiming a deduction for expenses or interest payable to a related interest where the latter is not required to include the items as income.

It has been held in a number of cases that the deduction was not allowable even though the related interest, on a cash basis, was required to include the expenses as income under the doctrine of "constructively received."

Recommendation.—Section 24 (c), Internal Revenue Code, should be amended to provide that such section shall not apply where the person to whom the payment is made elects to include such payment in his return for a taxable year ending within which ends the payor's taxable year. This would be analogous to the consent dividend provision in section 28, Internal Revenue Code.

9. Proposed section 123, H. R. 4473—Surtax exemptions and certain credits of related corporations

Need for change.—This is a new section proposed in the House bill. The provisions of the section are extremely technical and involved. In substance, they provide both for class A and for class B affiliations a single $25,000 surtax exemption under section 26, Internal Revenue Code, and likewise a single minimum excess profits tax credit under section 431, Internal Revenue Code, to all companies in the related group. For all practical purposes, the section has the effect of computing the tax on the basis of the equivalent of a consolidated return, without the privilege of offsetting profits of one corporation against losses of another, and without eliminating intercompany profits. Its object is to implement quite widely the purpose of section 129 of the code. The provision has apparently been worked out hurriedly, and may affect adversely many companies that should not be included within its scope.

Recommendation.—Since it appears that the Revenue Act of 1951 will be confined primarily to provisions of the code other than those relating to excess-profits taxes, and since only a limited study appears to have been given to this section, and since many inequalities will result from the enactment of the section in its present form, the proposed section should be referred back for further study and should not be included in the Revenue Act of 1951. On the other hand, if the section is finally enacted and appropriately limited, companies embraced within its provisions, whether as class A or class B affiliations, should be given the right to file consolidated returns.

10. Taxable year

Need for change.—Tax returns must be filed on the basis of a calendar year, or at the election of the taxpayer, on a fiscal year. The courts have held that a taxpayer has not elected a fiscal year where the tax return is based on a period ending on any day other than the last day of a month. In such case the calendar year must be used in disregard of the actual accounting period.

It has long been the accepted practice of many taxpayers to keep bookkeeping records on the basis of 13, 4-week periods, or four quarterly annual periods, each consisting of 13 weeks, instead of a 12-month period, because they find it more convenient to close their books on a Saturday rather than on the last day of a month. Where the annual accounting period does not end on the last day of the month, these taxpayers, in order to file on a fiscal year, are therefore forced to keep records to reflect the result of operations on a 12-month basis. In the long run, there is no advantage or disadvantage in permitting taxpayers to prepare their tax returns so that the year necessarily ends at the end of a month.

Recommendation.—Section 48, Internal Revenue Code, should be amended so that where a taxpayer consistently keeps his records on the basis of any recognized accounting "year" even though said year does not necessarily end on the last day of a month, he be permitted to file his tax return on the same basis.

11. Extension of time for filing returns

Need for change.—The Commissioner is authorized by section 53 (a) (2), Internal Revenue Code, to grant a reasonable extension of time for filing returns under such rules and regulations as he shall prescribe with the approval of the Secretary of the Treasury. Authority for granting extensions is delegated by the regulations to the various collectors of internal revenue.

In many cases undue hardship is imposed on the taxpayer, as well as on his accountant, where it is impossible to determine the correct income for the taxable year within 2½ months following the close of the year. Where an extension of time is not granted by the collector, the taxpayer is liable to the assessment of a delinquency penalty even though it is not possible to file a timely return.

Recommendation.—The Internal Revenue Code should be amended to provide that unless the Commissioner finds that a request for an extension is made for the purpose of delaying the payment of the tax, an extension for a period not exceeding 6 months to file an income-tax return shall be granted upon application of the taxpayer or his representative, provided a tentative return is filed showing the estimated tax and payments of the tax are made as in the case of regular returns.

12. Surtax on corporations improperly accumulating surplus

Need for change.—The administration of section 102, Internal Revenue Code, has resulted in many difficulties. In order to minimize some of these, taxpayers should have the option to claim a credit in computing undistributed section 102 net income for dividends paid after the end of the taxable year, but before the due date of the tax return, whether original or extended. Also, upon the imposition of a surtax under section 102 the corporation should be permitted to relieve itself of such tax in whole or in part through deficiency dividend procedure under the revision as proposed herein for personal holding companies or through appropriate consent dividend.

Recommendation.—Section 102 should be amended to provide:

(*a*) At taxpayer's option, dividends paid after the end of the taxable year, but before the due date (original or extended) of the tax return, should be allowed as a credit in computing undistributed section 102 net income.

(*b*) In the event of imposition of surtax under section 102, the corporation should be permitted to relieve itself of such tax, in whole or in part, by a deficiency dividend under conditions and procedure now prescribed in section 506 for personal holding companies, or, alternatively, by filing consent dividend papers, as provided in section 28, effective as of the original taxable year.

13. Income from fiscal-year partnerships and trusts

Need for change.—The bill, in common with the Revenue Act of 1950, increases the tax of fiscal-year individual and fiduciary taxpayers on a prorata basis. This affects very few taxpayers, since most individuals and taxpaying trusts report on a calendar-year basis. However, many individuals derive income from partnerships and trusts reporting on a fiscal-year basis. Neither the 1950 act nor the 1951 bill makes provision for allocating such partnership or fiduciary income. Accordingly, income earned in 1950 is taxed at the higher 1951 rates, and income earned in 1949 was taxed at the higher 1950 rates. This inequity requires a correction, in view of the sharp increase in individual tax rates from 1949 to 1951.

Recommendation.—Section 108, Internal Revenue Code, should be amended to provide that in taxing the next income of an individual from a trust or partnership having a fiscal period commencing in 1950 and ending in 1951, the prorata portion of such income applicable to 1950 should be eliminated from tax at 1951 rates, and should be taxed instead at the appropriate level of 1950 rates in the same manner as was applied in the corresponding provision of the Revenue Act of 1924 (section 207 (b)). This amendment should be effective as of January 1, 1950.

14. Disposition of property to creditor

Need for change.—The courts have held that where a creditor forgives in whole or in part the obligation of a debtor, no taxable income is realized by the debtor if he is insolvent immediately before and immediately after the forgiveness; and that if immediately after the forgiveness he is solvent, the amount forgiven, if not a gift, is realized only to the extent that the value of the assets are freed from the claims of creditors as a result of the transaction.

It has been further held, however, that the payment of a debt by the transfer of property to the creditor may result in taxable income to the debtor regardless of his financial condition; the transaction is treated as a sale of property for a consideration equal to the debt discharged.

Recommendation.—Section 111, Internal Revenue Code, should be amended to relieve taxpayers who are in unsound financial condition from tax on gain on the transfer of property to a creditor in settlement of a debt incurred in acquiring the property. The taxable gain (to the extent not a gift) should be limited to the value of the net assets which are freed from claims of creditors as a result of the settlement.

15. Gain from sale or exchange of taxpayer's residence

Need for change.—Section 303 of the House bill amends section 112, Internal Revenue Code, by adding a new subdivision (n), which provides for nonrecognition of gain on sale of a taxpayer's residence under certain conditions. Subsection 2 (F) of the proposed 112 (n) provides that in order to obtain the benefit of such nonrecognition, the taxpayer must acquire another residence within 1 year of the date of the sale resulting in the gain. Our attention has been directed to situations of taxpayers who have sold their homes and may not be able to purchase a new one within the 1-year limitation because of having been inducted into the Armed Forces, or having accepted temporary Government or defense-work employment in a city other than that of their normal residence.

Recommendation.—Section 112 (n) (2) (F), Internal Revenue Code, as proposed, should also provide that in such cases recognition of the gain shall be deferred with appropriate protection to the Government in the same manner as provided in section 112 (f) in other cases of involuntary conversion, where replacement is deferred.

16. Continuity of net losses, etc., in corporate reorganizations

Need for change.—Under sections 112 and 113, Internal Revenue Code, property acquired by a corporation in certain types of corporate reorganizations has the same basis for tax purposes as in the hands of the predecessor company. The underlying theory is that the successor steps into the "tax shoes" of the predecessor company. This theory, however, has not been extended beyond the basis of property except with respect to the status of life insurance as provided in section 110 of the Revenue Act of 1942. For example, net operating losses of the predecessor cannot be carried forward against income of the successor or vice versa. Interest paid on additional taxes asserted against the predecessor can be deducted by the successor only to the extent accrued since the date of the reorganization, and except possibly in the case of statutory mergers or consolidations. The tax-benefit rules provided in sections 22 (b) (12) and 127 of the code with respect to recoveries on bad debts or taxes or losses or other items previously claimed or allowable to the predecessor are not extended to the successor. Other items of expenses paid by the successor for the account of the predecessor, which would have been deductible by the predecessor, had it continued in existence, are not allowed as deductions to the successor. Likewise, certain classes of prepayments by the predecessor are not allowed as deductions to the successor.

Recommendation.—Where a corporation is formed or availed of to acquire the assets and become the successor, in a tax-free reorganization, of a predecessor corporation, which, in pursuance of the plan, is liquidated and dissolved, the successor corporation should step into the tax shoes of the predecessor corporation for all purposes, so as to permit the carry-back and carry-forward of net operating losses from one to the other, to continue the accounting methods and period of the predecessor and the application of the tax-benefit rule to recoveries by the successor of losses or deductions previously claimed or allowable to the predecessor, and so as to permit full deductibility by the successor of any payments which would have been deductible by the predecessor had the predecessor continued in existence.

17. Election as to recognition of gain in certain corporate liquidations

Need for change.—Section 112 (b) (7), Internal Revenue Code, provides for an election as to recognition of gain in certain corporate liquidations when the distributions in liquidation were made in 1951. The necessity for such an election is equally present in all years.

Recommendation.—Section 112 (b) (7), Internal Revenue Code, should be amended to include liquidations made after 1951.

18. Involuntary conversions

Need for change.—The interpretations given by the courts and the Commissioner to section 112 (f), Internal Revenue Code, dealing with involuntary conversions has unduly limited its scope. The regulations provide, for example, that the money spent for replacement must be from the actual proceeds. Under this rule it would not be possible to obtain the benefit of this section when, for example, condemnation or insurance proceeds resulting from the conversion of property are used to liquidate a mortgage on such property and new construction is financed by a new mortgage. Under these and similar circumstances the intended relief may be denied to those who need it most. Relief is also denied to a taxpayer who used his own general funds to replace converted property before the receipt of the conversion proceeds.

Recommendation.—Section 112 (f), Internal Revenue Code, should be amended specifically to extend its provisions to cover later acquisition of property to replace that involuntarily converted even if the proceeds of the conversion have in the meantime been used for general purposes; and to cover replacements of property in anticipation of the condemnation, or requisition, or the receipt of the proceeds.

19. Reorganizations

Need for change.—The provisions of section 112 (g) (1), Internal Revenue Code, have been rendered uncertain by a series of judicial decisions in cases involving reorganizations which have added such extrastatutory requirements as the so-called business-purpose test, with resulting discouragement of necessary corporate reorganization.

Recommendation.—Section 112 (g) (1), Internal Revenue Code, should be amended to remove the confusion and uncertainty as to the application of its provisions, particularly by defining the terms "business purpose," "continuity of interest," "securities," and "party to a reorganization."

20. Party to a reorganization

Need for change.—A common form of reorganization is the acquisition of substantially all the assets of one corporation by another through the issuance of voting stock by the acquiring corporation. For business reasons it is often desirable for the acquiring corporation to segregate the assets thus acquired into a controlled subsidiary. However, in such cases it has been held that the parent corporation is not a "party to a reorganization" within the meaning of section 112 (g) (2), Internal Revenue Code, with the result that the transaction does not qualify as a reorganization. There is no purpose or policy of the reorganization provisions which would be violated by recognition of the parent corporation as a "party to a reorganization" in this type of case.

Recommendation.—The definition of term "party to a reorganization" in section 112 (g) (2), Internal Revenue Code, should be amended to provide in substance that the term includes a corporation which issues its stock for stock or properties of another, whether such stock or properties are acquired directly by the stock-issuing corporation or by its controlled subsidiary.

21. Basis of property acquired by intervivos gift or through joint and survivorship ownership

Need for change.—Under section 113 (a) (2), Internal Revenue Code, where property is acquired by intervivos gift, the tax basis of the property to the donee is generally the same as the basis to the donor. Under section 113 (a) (5), if the property was acquired by bequest, the basis is that used in the donor's estate-tax return (sec. 811 (c) and (d)). Where an intervivos gift is included in the donor's estate-tax return, because made in contemplation of death, it is valued for estate-tax purposes as at date of death, yet the donee's basis remains that of the donor.

Likewise, in the case of the jointly owned property which is taxed in whole or in part for estate-tax purposes, the original cost and not the value for estate-tax purposes at the date of death remains the tax basis to the surviving owner.

Recommendation.—Section 113 (a) (2), Internal Revenue Code, should be amended to provide that where property acquired by gift is included in the estate of a donor for estate-tax purposes, the basis to the donee of the property with respect to depreciation, or gain and loss, for any period after date of death shall be the value included in the donor's estate-tax return.

Likewise, in the case of jointly owned property to the extent that the property was valued for estate-tax purposes, that portion of the value should be substituted for the same portion of the original cost as the basis to the survivor.

22. Capital gains and losses through fiscal-year partnerships

Need for change.—Section 305 of the bill proposes to make changes in the offset of net long- and short-term capital gains and losses under section 117, Internal Revenue Code, to be effective in the case of taxable years beginning after the enactment of the bill. No provision has been made with respect to the effective date of such transactions to fiscal-year partnerships. Apparently, as a result of the impact of sections 182 and 183, Internal Revenue Code, the application of the new provisions will become retroactive to transactions of partnerships as early as February 1, 1951. Since it appears to be the intent of the bill to avoid such retroactive effect, the provision should be properly worded to accomplish that purpose.

Recommendation.—The amendment proposed in section 305 of the bill should be changed so as to be applicable only to transactions of fiscal-year partnerships with taxable years beginning on and after the enactment of the bill.

23. Gains and losses on sales of capital assets

Need for change.—Sections 117 (a) (1) and 117 (j) (1), Internal Revenue Code, make a distinction between real property and depreciable property used in business, on the one hand, and intangible personal property or choses in action used in business, on the other. This despite the express intent of the Senate Finance Committee (Rept. No. 1083 dated October 2, 1942, p. 110) that "it considers it more appropriate to treat all property used in the trade or business alike and not to distinguish between land and other property used in the trade or business." Compare Rockford Varnish Co. (9 T. C. 171), and Carter-Colton Cigar Co. (9 T. C. 219).

There has been considerable uncertainty and attendant controversy over transactions in commodity futures reasonably necessary to the conduct of a taxpayer's business. The Commissioner has frequently urged that such futures are capital assets, although transactions in futures are necessary hedges for the protection or ordinary commercial transactions, with consequent ordinary income or deductions instead of capital gains or losses. See, however, Stewart Silk Corp. (9 T. C. 174).

Recommendation.—Sections 117 (a) (1) and 117 (j) (1), Internal Revenue Code, should be amended by adding the words "or intangible personal property or choses in action" after the words "real property." The amendments to both sections 117 (a) (1) and 117 (j) (1) will have the effect of allowing net losses on these added classes of property as ordinary deductions and taxing net gains on sales of such property held over 6 months as capital gains, and conform with similar treatment accorded real property and depreciable property.

Section 117 (a) (1) should exclude from the term "capital assets" any contract for future delivery of a commodity purchased or sold through a board of trade or on a commodity exchange or in a similar transaction necessary to the conduct by the taxpayer of his regular trade or business.

24. Partnership taxable year

Need for change.—When a partnership is dissolved by death of a partner the return of the deceased partner for his last taxable year includes his share of the partnership income for the period ending with the date of his death. As a result, the final return of a decedent often may include his share of more than 12 months' income of the partnership. For example, if the decedent is on a calendar-year basis and the partnership is on a fiscal-year basis ending May 31, and the decedent died on November 30, there would have to be included in his final return his share of the income of the partnership for the 12 months ended May 31 and also his share of the income for the 6 months ended November 30.

The problem has also arisen as to the effect of the death of a partner on the partnership income of the remaining partners, i. e., does the partnership terminate because of the death and does it require the remaining partners to include their share of more than 12 months' income. Although the courts have held in many cases, for example, where the partnership is continued for the purpose of liquidation and under other circumstances, that the death of a partner does not terminate the taxable year of the partnership with respect to the remaining partners, the question nevertheless should be definitely settled by statute.

Recommendation.—Sections 126, 183, and 187, Internal Revenue Code, should be amended to provide that the death of a partner shall not be deemed to change the taxable year of the partnership and that the share of the income of the deceased partner to date of death and the share of the income of all other partners, shall be reported in the taxable year within which the partnership year would have ended if there had been no death.

The foregoing amendments should be made retroactive to all years not closed by the statute of limitations.

25. Election to file consolidated return

Need for change.—Since 1940 corporations, generally, have had the option of filing consolidated returns. The regulations promulgated by the Commissioner under section 141, Internal Revenue Code, require that corporations, which file a consolidated return for 1 year, must continue to file on that basis unless the Commissioner rules that a new option is available. In all but 1 year since 1940, the Commissioner has given corporations a new option. The situation, however, has been uncertain during this period. In order to remove that uncertainty, and in order not to bind corporations with an election that may prove to be inequitable, corporations should have an annual option to file either consolidated or separate returns.

Recommendation.—Section 141, Internal Revenue Code, should be amended to give corporations an annual election to file consolidated or separate returns.

26. Taxability of income of trust which may be used for payment of insurance premiums on the life of the grantor

Need for change.—Following the Supreme Court decision in *Helvering* v. *Stuart* (317 U. S. 154), making a grantor taxable on the income of a trust which could be used for the support of a minor child, section 167 (c) was enacted, limiting such grantor-taxability to the amount of the income actually expended for such purpose. A similar limitation should be provided in the case of trusts with life insurance provisions, as to which it is now provided, in section 167 (a) (3), that the income of such a trust is taxable to the grantor if it may be expended on premiums on insurance on the grantor's life, irrespective of whether or not it is so expended.

Recommendation.—In the case of trusts, the income of which may be used to pay life insurance premiums on the life of the grantor, such income should be taxable to the grantor only to the extent that the income is actually expended for such purpose.

27. Offset of overpayment of tax against related deficiency

Need for change.—The code often fails to offset a deficiency under section 271, Internal Revenue Code, of one class of tax against an overpayment of another class of tax although the two classes of taxes are related or interdependent. This situation was cured in connection with the excess profits tax under the Excess Profits Tax Act of 1950 by having such taxes a part of the corporation income tax and not an independent tax. The situation still exists with respect to the income tax and related personal holding company surtax under section 500, Internal Revenue Code, and has not been corrected in connection with most related taxes for prior years.

Recommendation.—The code should be amended to provide that where a deficiency is offset by an overpayment of a related tax which has been determined by the Commissioner, the taxpayer may file a claim for credit of the overpayment against the deficiency, and the collection of the deficiency shall be suspended until the claim is acted upon by the Commissioner. Consideration should also be given to applying this provision retroactively in order to eliminate excess interest collected on deficiencies to the extent that it is administratively practical to do so.

28. Waiver of restrictions on assessment and collection of deficiency in tax

Need for change.—Section 272 (d), Internal Revenue Code, covers waivers on assessment and collection of "the whole or any part" of a deficiency. It is often difficult, if not impossible, for the taxpayer to obtain a waiver of partial deficiencies. The Commissioner's regulations and administration also tend to narrow the section by requiring the waiver to be filed with the Commissioner and acted upon by him.

Present administrative procedure in this respect costs the taxpayer additional interest, and wastes the time of the taxpayer and his representatives as well as that of Bureau personnel and the courts.

Recommendation.—Section 272(d), Internal Revenue Code, should make it mandatory upon the Commissioner to accept waivers on assessments and collection of all or any part of a proposed deficiency.

29. Consent fixing period of limitation upon assessment of income and profits tax

Need for change.—Section 276(b), Internal Revenue Code, covering waivers extending the limitation period upon assessments is based on mutuality of agreement. In practice, the mutality is often more apparent than real, for in the event of a taxpayer's refusal to sign the waiver, an arbitrary deficiency by the Commissioner may immediately follow. The present attitude of casualness in requesting the waiver from the taxpayer operates to make the statute of limitations meaningless.

Recommendation.—Section 276(b), Internal Revenue Code, should make it mandatory upon the Commissioner to sign the waiver for a period of 1 year on the written request of the taxpayer. Request for a waiver by the Commissioner or his agent should be in writing. Requests for a waiver should state the reasons for the requests. If made by the taxpayer, a request should be submitted directly to the Commissioner; if made by the Government, it should be made by the Commissioner or his designated assistant.

30. Elections to file joint or separate returns, standard deduction, etc.

Need for change.—A taxpayer must make many elections that are irrevocable, for example, the election to file joint or separate returns. As a proper election requires informed tax knowledge of existing law and future interpretations of the law, not possessed by the average person, the election may result in a substantially excessive tax. The elections with respect to at least joint or separate returns, taxation under section 400, Internal Revenue Code, supplement T and standard deduction should be revocable.

Recommendation.—Elections as to (a) joint or separate returns of husband and wife and (b) taxation under supplement T and (c) standard deduction should be revocable within the period during which a refund claim may be filed. The taxpayer should be permitted to file a refund claim within such period based on the changed election.

31. Recommendations with respect to personal holding companies

Need for change.—A deficiency dividend is impossible where the corporation has previously been liquidated. It is also impractical where the finances of the personal holding company do not permit it. Consent dividend procedure is a practical solution. Deficiency dividend procedure is permitted only in the case of timely returns where failure to file a timely return is established to be due to reasonable cause and not to willful neglect. This denial should be confined to fraud cases, since the technical provisions applicable to personal holding companies have been found to be so difficult of administrative or judicial interpretation that many companies have inadvertently and innocently failed to file such returns on time.

In computing the income of a personal holding company which is subject to tax under subchapter A, a deduction is allowed under section 505 (a), Internal Revenue Code, for the Federal income tax paid or accrued during the taxable year. The purpose of this deduction is to avoid the imposition of the income tax and the personal holding-company tax on the same income. This purpose is accomplished where the taxpayer is on the accrual basis, because the income tax accrued is that for the year subject to the personal holding-company tax. The purpose is not accomplished where the taxpayer is on the cash receipts and disbursements basis, for it is required to deduct the income tax paid, which is the tax imposed on income of the previous year.

Recommendation.—(*a*) Effectuation of deficiency dividends by consent dividend procedure should be authorized.

(*b*) Deficiency dividend procedure should not be denied in cases of nonfraudulent delinquency in filing personal holding-company tax returns.

(*c*) The deduction of the Federal income tax, in computing undistributed subchapter A net income, should be the tax for the taxable year, whether the corporation is on the cash basis or the accrual basis.

32. Estate tax: Credit for gift tax on inter vivos gifts

Need for change.—Under sections 811 (c) and (d), Internal Revenue Code, an inter vivos gift included in the estate-tax return of the donor, increases the estate in the highest tax bracket, although the credit against the estate tax for gift tax is, under section 813 (a), Internal Revenue Code, computed on an average basis.

Recommendation.—Section 813 (a), Internal Revenue Code, should be amended to provide that the credit for gift tax allowable against the estate tax shall be the amount by which the donor's total gift-tax liability was increased by inclusion of the property for gift-tax purposes.

33. Estate tax on remainders to charity subject to a power of invasion of principal, etc., should be determined by the ultimate event

Need for Change.—Ordinarily a bequest to a charitable or educational organization, etc., whether outright or as a remainder after an intervening life or lives, is exempt from estate tax (sec. 812 (d) I. R. C.). However, a Supreme Court decision (*Merchants Bank* v. *Commissioner*, 320 U. S. 256) holds that where the gift is of a remainedr interest and, where, during the intervening life or lives, the principal may be invaded for the benefit of the life beneficiary, the amount of the gift to charity is not determinable and, hence, no deduction therefor may be allowed in computing the net taxable estate—with the result that no part of the gift to charity is exempt, even though the power of invasion is never exercised. A similar situation is produced where the remainder bequest to charity is contingent.

Recommendation.—The degree of exemption should be determined by the ultimate event and the exemption allowed should be reduced only to the extent to which the power of invasion of principal is actually exercised or, in the case of contingent remainders, the exemption should be allowed in accordance with the actual occurrence of the events upon which the bequest to charity is conditioned. The Government can be amply protected, in the meanwhile, by requiring either immediate payment of the tax, or the posting of a bond, with refund, or final settlement under the bond, to be made upon the occurrence of the events which finally determine the amount of the gift of the remainder to the charitable or similar organizations.

34. Mitigation of effect of limitation

Need for change.—Section 3801, relating to mitigation of the effect of limitations, does not relieve the hardship in many meritorious situations. For example, if the Commissioner shifts an item of income from a barred year to an open year, or a deduction from an open year to a barred year, the taxpayer in equity and good conscience should be entitled to a refund for the barred year. The Commissioner at present has no power to grant the refund.

Recommendation.—Section 3801 (b), Internal Revenue Code, should be amended to cover the following additional situations:

(1) When a deduction is made in good faith on the tax return of 1 year and is disallowed by the Commissioner on the ground that it was deductible in a return of a different year.

(2) When income is included by the taxpayer in good faith in 1 year and is held by the Commissioner to be taxable in another year.

(3) When the basis of an asset claimed by taxpayer is reduced by the Commissioner for the purpose of computing net income of 1 year on the ground that the reduction of the basis should have been made in another year.

(4) When income or deductions are included or deducted by one member of an affiliated group, as defined in section 141 (d), Internal Revenue Code, and are allocated by the Commissioner to another member of the group.

35 Elections under the Excess Profits Tax Act of 1950

Need for change.—Numerous elections are provided under the Excess Profits Tax Act of 1950, many of which are irrevocable. The technical provisions of the act, the uncertainties of the application of these provisions, the limited time that has elapsed since the act was passed, the comparative newness of the rulings under the act, and under the regulations, make the exercise of such elections a gamble. Consequently, two corporations which have precisely identical net income and available credits may have different tax liabilities solely as a result of exercising or failure to exercise certain elections.

Recommendation.—The exercise or failure to exercise elections under the Excess Profits Tax Act of 1950 by corporate taxpayers shall not be irrevocable but may be changed at any time up to the running of the limitations for the determination of the tax.

36. Unused excess profits credit carry-over—Effect of carry-back to preceding short taxable year

Need for change.—Section 432 (c) requires that an unused excess-profits credit must first be carried back. In the case of a prior short taxable year, the carry-forward, if any, is reduced by the annualized adjusted excess profits net income of the preceding short taxable year. This requirement is inequitable as it uses up more of the unused credit than it properly should.

Recommendation.—Section 432 (c) (2) should be amended to provide that a carry-over of unused excess-profits credit shall be reduced by the lesser of (a) the amount provided in section 432 (c) or (b) such portion of the unused excess profits credit carry-back to the short taxable year as the number of days in the short taxable year is of the number of days in the 12 months ending with the close of the short taxable year.

37. Section 433 (a) (1) (J)—Net operating loss deduction adjustment

Need for change.—Sections 122 (b) (2) (B) (ii) and 433 (a) (1) (J) require that where there is a net income in 1949, an elective base-period loss under section 433 (a) (1) (J) and a net loss in 1950 that the loss carry-overs to 1951 be reduced by the 1949 income both under section 122 (b) (2) (B) (ii) and section 433 (a) (1) (J).

Recommendation.—Section 433 (a) (1) (J) should be amended to eliminate this duplication in the adjustment of net operating losses because of income in the year 1949.

38. Abnormal deduction in base period

Need for change.—Section 433 (b) (9) Internal Revenue Code provides for the adjustment of income of base-period years by way of disallowance of abnormal deductions. The relief, which it appears this section was intended to afford, has been emasculated by the 5-percent rule of section 433 (b) (10) (B), which provides that no adjustment shall be made for an abnormal deduction of any class unless the amount of such adjustment exceeds 5 percent of the average excess profits net income for all taxable years in the base period. A taxpayer may have a number of abnormal deductions, the adjustment for all of which would increase the average excess profits net income for the base-period years. But unless each adjustment exceeds 5 percent, no adjustment is permitted. The corresponding relief provision of the prior excess profits tax law (sec. 711 (b) (1) (J) I. R. C.) did not have the 5-percent limitation.

The relief is further emasculated by the requirement of section 433 (b) (10) (C) (i) that no adjustment for an abnormal deduction shall be made unless the taxpayer establishes that the increase in the deduction is not "a cause or a consequence of an increase in gross income * * * or a decrease in the amount of some other deduction * * *." It is almost impossible for taxpayers to establish that a particular deduction was not a cause of an increase in income or decrease in some other deduction. Section 711 (b) (1) (J) did not have the cause test.

Recommendation.—Section 433 (b) (10) (B) should be amended to eliminate the 5-percent rule. Section 433 (b) (10) (C) (i) should be amended to eliminate the cause test.

39. Average base period net income—abnormalities during base period

Need for change.—The base period income credit generally is based upon the income of the best 36 months out of the 4 years, 1946–49. This result is accomplished by eliminating the poorest 12-month period. Provision is made in section 442 Internal Revenue Code for adjusting the base-period income when certain abnormalities exist. However the adjustment is limited to the 36 months remaining after the poorest 12-month period is eliminated. Situations have developed in which all or part of abnormality is in the poorest 12-month period. A more equitable result would be obtained by adjusting the income for each month of the base period for abnormalities and then eliminating the resulting poorest 12-month period.

Recommendation.—Section 442 Internal Revenue Code should be amended to provide that the income of each month of the entire base period should first be adjusted for abnormalities, and the resulting poorest 12 months eliminated.

40. Average base-period net income—new corporations

Need for change.—Section 435 (d), Internal Revenue Code, provides that if a corporation was not in existence during the entire base period then, in computing its average base-period net income, the excess-profits net income for any month of the base period that it was not in existence shall be taken as zero. Such a corporation, as a "new corporation," may receive a greater credit under section 445 through the use of a credit computed on industry averages. However, in many cases section 445 affords no relief. Equitably a new corporation should be permitted to compute its average base-period net income by using its actual net income for such months of the base period as it was in existence, plus a constructive income for the months that it was not in existence.

Recommendation.—Section 435 (d) (1), Internal Revenue Code should be amended to provide that a corporation that was not in existence during the entire base period can compute for the period that it was not in existence constructive earnings measured by one of the following:

(*a*) The industry experience for the particular period;

(*b*) A credit of 12 percent of the average of its invested capital during the remainder of the base period;

(*c*) The earnings of the portion of the base period that the company was in existence converted to the prior portion on the basis of economic factors applicable either to the particular industry or the economy of the country as a whole. The method of such conversion can be stated in the code in order to minimize administrative difficulties.

41. Average base-period net income, alternative based on growth

Need for change.—Section 435 (e), Internal Revenue Code is limited to companies that were in business at the beginning of the base period and thereby rules out many companies whose operations began early in 1946. As noted in the discussion in the prior item under section 435 (d), many new companies receive no benefit from the relief provisions and their excess profit credit has been impaired by the general average provisions.

Recommendation.—In order to be reasonably applied, the growth provisions should be extended to such new companies through reconstructing the company's operations for that portion of the base period for which it was not in existence in determining sales, wages, and net income. This would place such companies on a par with companies that were in existence throughout the base period under the growth provisions.

42. Capital addition in base period

Need for change.—A capital addition is allowed in section 435 (f) Internal Revenue Code for retained earnings during the last two taxable periods preceding the first excess-profits tax year. Such last two taxable years of some companies, as a result of a change in fiscal year, may have been less than 24 months and their base-period capital addition is accordingly inadequate.

Recommendation.—Section 435 (f) Internal Revenue Code should be amended to provide that where the last two taxable periods prior to the first excess-profits tax year cover a period of less than 24 months, the taxpayer may, for the purpose of computing the base-period capital addition, prorate the income of a sufficient period of the preceding 12 months to make up the full 24 months.

43. Excess-profits credit, based on income-effect of reduction in inadmissible assets upon net capital addition and reduction

Need for change.—An increase in inadmissible assets during the last 2 years of the base period reduces the base-period capital addition with a corresponding decrease in the excess-profits credit. On the other hand, a reduction after the base period in the inadmissible assets does not form part of the net capital additions under section 435 (g) Internal Revenue Code and, therefore, does not increase the excess-profits credit, except to the very limited extent that such reduction in inadmissible assets is subtracted from capital reductions.

Recommendation.—A reduction in inadmissible assets after the base period should be part of the capital addition in computing the excess-profits credit.

44. Net capital addition or reduction—Loans to members of a controlled group

Need for change.—Section 435 (g) (7) requires a reduction under section 435 (g) (4) (E) for the increase on any day during the taxable year in loans to members of a controlled group. It does not, however, provide that the increase on such day may be reduced by a subsequent decrease during the taxable year.

Recommendation.—Section 435 (g) (7) should be amended to provide that the reduction under section 435 (g) (4) (E) shall be determined by the excess of the average amount of loans to members of a controlled group during the year over the corresponding amount at the beginning of the first taxable year under the subchapter.

45. Relief provisions

Need for change.—Sections 443, 444, and 445 Internal Revenue Code embody formulas for the determination of relief through the use of a percentage of total assets determined by the Commissioner after a study of base-period returns of companies in the same industry. Experience has indicated that the use of the industry percentages required by the above sections, and as preliminarily determined by the Commissioner, have developed the following inequities:

(*a*) The average of 4 years has been used. This includes loss years and years of poor results. Companies not using the industry figures may use the best 36 months of the 48 months of the base period, and are not required to reduce earnings by losses, which are never figured below zero. Even the application of the average of the 3 best years of an industry as a whole is not comparable to the use by a company of its own three best years out of 4, since inevitably some companies in an industry will do better in one year of the base period and other companies will do better in a different year. A comparable line-up of industry figures would require, if it is feasible, an aggregation for all companies in an industry, of the best 3 years for each company out of 4. In the alternative, at least the poorest industry year should be eliminated in the application of industry figures.

(*b*) The industry figures are based upon the tax returns as filed, with no adjustment for either changes resulting from Treasury Department examinations or elimination of inadmissible assets, both of which are given effect in the case of companies to whom the relief provisions are not applied. The Treasury Department's experience with corporations as a whole for the base period should be applied to the industry figures in order that they be more realistic in regard to the aforesaid items.

(*c*) The industry classifications appear to be too limited in number and do not generally reflect the larger number of industries so as to afford appropriate application of these sections.

(*d*) The base-period capital addition is permitted only in the case of companies with abnormalities during the base period qualifying under section 442. Such additions are not permitted in the case of companies qualifying under the other relief sections, namely 443 through 446 of the code. In order that all companies receive equality of treatment, the base period capital addition should be applied, regardless of whether the tax is computed under the general average or under any of the sections 442 through 446.

16. Abnormalities in income in taxable period

Need for change.—Section 456 (a) (2) (C) Internal Revenue Code lists as a separate class of abnormal income the income from the sale of patents, formulas, or processes, but does not include as abnormal income the income from research or development of such items or of tangible property. The result is that abnormal income from research and development is completely subject to the excess-profit tax, even though it may have resulted from research and development extending over a period of more than 12 months during periods other than the excess-profits tax years. Under the prior excess-profits tax (sec. 721 (a) (2) (C) I. R. C.), such income was recognized as a class of abnormal income.

Recommendation.—Section 456 (a) (2) (C) should be amended to include income from research and development, in the same manner as under section 721 (a) (2) (C) of the prior excess-profits tax law.

Statement of Air Transport Association of America, Washington, D. C.

The Air Transport Association of America, which represents virtually all of the certificated airlines operating under the American flag, urges the committee not to impose an additional gasoline tax on the airlines. Gasoline used by the airlines is not a commodity which, under tests prescribed by Secretary Snyder, should be taxed at an increased rate. The proposed increase not only would have a serious impact on the industry, but would discriminate among the airlines, falling particularly heavily on the smaller airlines.

In the hearings before the Ways and Means Committee, Secretary Snyder made two tax proposals which directly affect the airlines. He suggested that the corporate income tax be raised by 8 percentage points, and that the present 1½-cent gasoline tax be increased to 3 cents per gallon.

H. R. 4473, as passed by the House, would increase corporation income taxes by 5 percentage points and, due to changes made in the excess profits tax, would produce approximately as much income tax revenue from corporations as recommended by the President. We do not raise any question with respect to the proposed increases in income taxes on corporations since they will apply to business generally. They will not be levied so directly and specifically against the airlines as is the proposed increase in the gasoline tax.

H. R. 4473 would increase the gasoline tax from 1½ cents to 2 cents per gallon. In his testimony before this committee, the Secretary pointed out that the net yield of H. R. 4473 is about $7 billion, or roughly $3 billion less than the goal set by the President. The Secretary urged that this gap be closed, and that approximately $2 billion extra revenue be obtained by further increases in "selected excise taxes," including an increase in the gasoline tax from 1½ to 3 cents, as originally proposed to the House committee.

We are greatly concerned with the Secretary's proposal to double the tax on gasoline. The air transport industry operates on gasoline. It is the heart of our business. It is our basic raw material, as is coal to the steel mills. The domestic airlines will use an estimated 425,000,000 gallons of aviation gasoline during 1951. Consequently, they would be hit particularly hard by such an increase in this tax.

There are three principal reasons why the Congress should not increase the tax on gasoline used by the airlines.

1. Gasoline used by the airlines is not a commodity which, under tests prescribed by Secretary Snyder, should be taxed at an increased rate.

In his statement before the Ways and Means Committee, the Secretary pointed out that additional revenue was to be raised from excise taxes "on those consumer goods which are less essential or which use materials that will be in short supply." The gasoline used by the airlines clearly does not fall in either of those categories.

There can be no question but that continued operation and rapid expansion of the airlines is a prime essential. The Nation's economy has become more and more reliant upon the speed and services of air transportation. Moreover, the increasing tempo of our production machine is going to require rapid expansion of the airline industry. An even further expansion is required by the fact that military plans for airlift requirements generally are hinged upon the use of a high percentage of the commercial airlines' fleet. In a speech in the fall of 1950, the Secretary of the Air Force, in speaking of the requirements for air transport in times of emergency, stated in part: "When we * * * take into consideration * * * not only the military planes available but a practicable percentage of the civilian airlines which might be taken over in the event of war, we find a very substantial deficit." Thus, for both business and military uses the airlines must expand, and the use of gasoline is essential to that expansion.

Nor does the Secretary's reference to materials which are in short supply apply to the gasoline used by the airlines. Presumably he had in mind that a tax imposed on such materials would discourage their purchase and use. But, as stated, it is quite clear that the public interest does not require a reduction in the use of gasoline by the airlines—it requires just the opposite.

2. The proposed increase would have a serious impact on the industry.

If the proposed increase is adopted, our conservative estimate is that the industry would pay to the Federal Government in the neighborhood of $13 million a year in gasoline taxes alone, based on 1951 figures. An item of $13 million does not create much of an impression any more, but this amount of money is a very heavy burden to the air transport industry. The total amount of gasoline taxes which the airlines would pay to the Federal Government under the Treasury Department's proposal would mount to more than their total net profits in 1949, and about 50 percent of those for 1950 and 1951.

There is attached to my statement a table which shows, for each domestic airline, the percentage which the proposed additional gasoline tax it would have to pay, bears to its net operating income, before income taxes.

A review of that table reveals that of the 32 airlines listed, 7 operated at a loss in 1950. That even for the airlines with the largest net operating income, the increase in gasoline taxes alone would constitute 5.2 percent of that income. In one case the increase in tax would be more than seven times the net operating income. Generally, for airlines with comparatively small net operating income, the new tax would virtually wipe out anticipated small profits.

The total tax increase would be 9.8 percent of the total net operating income of the domestic airlines. Thus, the airlines would be subject not only to the proposed additional income taxes, but also to an additional similar burden which is even higher.

Even if it were possible for the airlines to require the air traveler to absorb every bit of the additional gasoline tax—and we do not think it is—it seems unfair and inequitable to impose an additional burden of taxation upon him. He is already paying very substantial taxes for the privilege of riding on an airplane. In the year 1949 the air traveler paid $46,700,000 in transportation taxes. In 1950 he paid $53,200,000, and it is estimated that in 1951, his tax bill will be increased to $66,500,000. It seems to us that the air traveler is paying enough. Apparently the Secretary thought so, too, since he proposed no increase in the transportation tax rate.

Most Federal taxes, unlike the gasoline tax, are expressed as percentages of the tax base. While a tax of 3 cents per gallon, at first blush, sounds rather innocuous, the full burden of the tax can be appreciated when it is expressed as a percentage of the price of the article taxed. The airlines buy their gasoline at prices in the neighborhood of 17 to 19 cents per gallon. A 3-cent tax on a gallon of gasoline purchased at 17 cents amounts to a tax of approximately 18 percent. That is a "luxury tax rate," as witnessed by the fact that the excises on jewelry, furs, cosmetics, and cabaret checks are only 20 percent. But gasoline is no "luxury" to the airlines—it is their lifeblood.

3. The tax would discriminate among airlines

An even greater objection to the proposed gasoline-tax increase is the fact that the heavy burden which it would impose is not, and cannot, be spread evenly over the industry. It is the small airline that is particularly hurt. As a matter of fact, the smaller and weaker the airline, the more heavy the burden of the tax.

Some airlines have a high percentage of long-haul traffic between major traffic centers; others, particularly the feeder lines, serve primarily the smaller cities where the traffic volume is very small. For this reason, the percentage of seats occupied on the airplanes of the various companies will vary from 70 percent down to as low as 25 percent.

The gasoline tax, which is an arbitrary figure assessed against the purchase of each gallon of gasoline, bears no relationship to the ability of the particular airline to pay the tax. No consideration is given to the earning capacity of the airline, the traffic-producing potentialities of its route, or to the passengers or other cargo that it carries. Most of the smaller airlines operate DC-3's, which consume about 100 gallons of gasoline an hour. On the basis of the proposed tax, they would have to pay $3 tax for each hour a DC-3 is operated. They would have to pay this same $3 even though they were actually carrying only six or seven passengers in the airplane. These smaller airlines, who fill only 25 to 35 percent of their seats, have no way of mitigating the discriminatory effects of the tax except by applying to the Government for subsidy, and it is clearly unsound policy to impose a tax upon an airline and promptly increase Government subsidy payments in amounts sufficient to offset the tax.

For all of the reasons we have stated, we hope that the committee will not impose any additional gasoline tax on the airlines. We do not believe that such a tax increase is necessary in order to insure that air transportation makes its proper contribution to the additional revenues required. The 15-percent transportation tax, for instance, which is collected for the Government by the airlines, will increase from $53,200,000 in 1950 to about $66,500,000 in 1951, thus providing additional revenue of $13.3 million. This increase is twice the amount which would be collected by a 1½-cent increase in the gasoline tax.

Relationship of proposed increase in gas tax of 1½ cents to net operating income, before taxes, of carriers in 1950

Company	Net operating income	Percent tax increase to net operating income	Company	Net operating income	Percent tax increase to net operating income
	Thousands			*Thousands*	
American	$22,919	5.2	All American	Loss	....
Braniff	2,105	8.6	Bonanza	Loss	....
Capital	2,237	15.5	Central	Loss	....
Colonial	Loss	....	Empire	24	54.2
Continental	384	17.9	Frontier	Loss	....
Chicago & Southern	704	13.7	Lake Central	26	39.1
Delta	2,151	10.6	Mid-West	34	8.5
Eastern	9,501	9.5	Piedmont	274	13.5
Inland	481	6.7	Pioneer	228	16.2
Mid-Continent	681	11.6	Robinson	Loss	....
National	2,470	7.6	Southern	117	16.3
Northeast	121	45.9	Southwest	261	9.6
Northwest	59	(1)	Trans-Texas	142	21.5
Trans-World Airlines	6,687	12.8	West Coast	98	13.4
United	14,218	7.3	Wiggins	Loss	....
Western	1,187	9.6	Wisconsin Central	164	7.5

1 Proposed increase in gas tax would be $443,415, or more than 7 times the net operating income.

MEMORANDUM OF R. E. DU MONT, ASSISTANT TREASURER OF THE DUKE ENDOWMENT, NEW YORK CITY

In connection with the proposed tax withholding at source from dividends and interest, consultations have been held with religious, charitable, and educational organizations and pension-fund organization, seven banking institutions in connection with their corporate divisions, trust divisions, pension divisions, and banking divisions, also with a number of the larger religious denominations, and all expressed hope that this proposed withholding will not be adopted and will not become part of our tax law.

Some certain reasons why this withholding will adversely affect tax-exempt entities are as follows:

1. Millions of dollars will be constantly frozen in the hands of the Treasury Department.

2. Income will be diminished due to loss of income on funds frozen with the Treasury Department.

3. Application of funds to the specific purposes for which they have been dedicated will be retarded. This will have a chain effect upon beneficiaries who rely upon current distributions to meet current operations.

4. Actuarial basis of pension trusts will be seriously disturbed. (Payments made into pension funds are partially based upon prompt investment of income.)

5. When dividends are paid other than in cash (taxable stock dividends), tax-exempt entities will be required to furnish the paying corporation with an amount equal to 20 percent of the market value of the stock dividends.

6. Additional expenses will be incurred in maintaining necessary records and in requisitioning refunds.

Some complications which will present themselves if this withholding proposed becomes effective are as follows:

1. Many of the tax-exempt entities hold securities registered in the name of registered nominee corporations, and the paying entity does not know who the actual owners are and, therefore, could not furnish the Treasury Department with this information. This would complicate exemption at source should that method be considered. This would also be true in connection with stock purchased or sold but not actually transferred on the books of a corporation before the payment date of record. These situations would also complicate the checking of refunds unless the books of the tax-exempt entities are relied upon for checking purposes.

2. Bonds held by pension funds are to a large extent held in coupon form, and the complications mentioned under item 1, above, will also prevail in connection with coupon bonds.

3. When bonds are traded in between interest dates, the seller will receive from the buyer accrued interest to date of sales, but the buyer will have to retain 20 percent of the accrued interest to cover part of the tax which will be withheld at source on the next regular interest payment date. This may have some effect upon the market, because the buyer will have temporary use of the tax put up in advance by the seller.

4. Many securities are originally issued on a true discount basis and, therefore, carry no fixed interest rates, which presents the problem of determining the income on which the tax should be withheld.

5. Auditing of refunds will be a considerable problem to the Treasury Department. It will be a very sizable task and a costly one in dollars and in time both to the Government and the tax-exempt entities. Records of all tax-exempt entities will at all times have to be available for examination by the Treasury Department. This is presently necessary concerning organizations exempt under section 101 (6), Internal Revenue Code, which have to file form 990 annually, but this has not been the case concerning tax-exempt entities organized solely for religious or educational purposes.

6. Accounting records of tax-exempt entities usually reflect the amortized earned-interest income (often on an accrued basis). Therefore, in order for the Treasury Department to determine the amount of interest received on which the 20-percent tax has been withheld, the earned income as shown by the books will have to be converted back into cash-interest income.

Being mindful of the adverse effect this withholding would have upon tax-exempt entities and readily vizualizing the many difficulties which might be encountered in obtaining a refund, a refund procedure was developed which, if adopted, would enable refunds of tax withheld to be obtained currently and at the same time provide the Treasury Department with a considerable amount of certified evidence to support the accuracy of the refund. This method might go a long way in relieving the Treasury Department of the vast amount of checking which will be necessary, such as delving into voluminous records or obtaining a vast amount of information at source. (As stated heretofore, it is just about impossible to obtain complete information at source.) The refund procedure has been worked out in cooperation with five large New York City banks and two suburban banks, and meets with their approval, and it could be put into operation without much disturbance to the bookkeeping methods presently employed by the banks.

The procedure outlined below would relieve tax-exempt entities of some of the burden this proposed tax withholding at source would impose and provide all such entities with a means of obtaining a tax refund each month. The Ways and Means Committee of the House of Representatives, recognizing that refunds should be made to tax-exempt entities as quickly as possible, has proposed that such entities able to do so be permitted each month to offset, against funds held by them representing taxes withheld from wages for social security, etc., the tax withheld at source from dividends and interest. There are many tax-exempt entities which will not be able to obtain a tax refund in this manner; however, if the procedure suggested below is permitted, all tax-exempt entities would receive like consideration.

SUGGESTED PROCEDURE

1. The tax-exempt entity would file with its depositary or depositaries a certification, verified by the Treasury Department, of its tax-exempt status. An acceptable form would be prescribed by the Treasury Department.

2. A dividend payment or interest-payment order would be filed with corporations or their paying agents for all stocks and bonds registered in the name of the tax-exempt entity, so that all dividends and interest on such investments would be received through a depositary. All income on stocks and bonds owned by such an entity, but registered in the name of a nominee, etc., would be collected through the depositary, as would all interest on bonds held in coupon or bearer form. This procedure is suggested as a means of proof of receipt of income.

3. The depositaries, upon receipt of dividends and interest, representing 80 percent of the amount due, would credit the proper account of the tax-exempt entity. Depositaries would be looked to for the correctness only of the dividends and interest on stocks and bonds held by them in custody. The correctness of all other income would be determined by the tax-exempt entity, with all necessary adjustments made through the proper account with its depositary.

4. Each month, the tax-exempt entity would file with its depositary a certification (in duplicate), in such detail and form as prescribed by the Treasury Department, of the income its depositary has received and credited to its account during the month. This detailed certification would set forth the income due, the refundable tax withheld, and the net amount received, and would be checked by the depositary against its control records.

5. Attached to the certification statement submitted by the tax-exempt entity to the depositary would be a draft on the Federal Reserve bank by the tax-exempt entity payable to the depositary for the account of such entity in the amount of the tax refundable. This draft would be in a form prescribed by the Treasury Department and would contain the endorsement and guaranty of the depositary similar to the following, or in a form to be prescribed by the Treasury Department:

"By endorsement of this draft, the depositary bank guarantees—

"1. That the drawer has filed with the depositary bank a Treasury certificate evidencing its tax-exempt status.

"2. That the draft has been signed by a duly authorized officer of the drawer.

"3. That the proceeds have been credited to the drawer's account.

"4. That the amount of the draft does not exceed 25 percent of the total interest and divided payments credited to the drawer's account in the depositary bank during the preceding calendar month."

The draft would be presented by the depositary to the Federal Reserve bank accompanied by the duplicate copy of the tax-exempt entity's certification. If the Treasury Department would honor these drafts, it will result in the tax-exempt entities obtaining each month a refund of the tax withheld at source during previous month.

A form of draft which might be considered is as follows:

WITHHELD-TAX REFUND DRAFT

NEW YORK..............19 1-120
210

Pay to the order of.. $..........

For account of..

.... Dollars

To: Federal Reserve Bank of New York,
Fiscal Agent for
Treasurer of the United States

(Authorized signature)

Concerning interest on bonds, notes, etc., traded in between interest dates, the certification will always agree with the depositary's control if tax is withheld only on regular interest-payment dates. If tax withholding on accrued interest is taken into account by buyer and seller on between-interest-date transactions, there will be certain instances where tax refunds requested in the certifications will be less than 25 percent of amount shows by the depositary's control as collected. For example:

(a) Where a tax-exempt entity buys a bond, etc., between interest dates and holds the security at the next regular interest date, the refund requested would be based on the period such entity held the security.

(b) Where a tax-exempt entity sells a bond, etc., between interest dates, providing such entity held the security on the previous regular interest payment date, the tax refund requested will be 25 percent of the amount the depositary would show as collected, but if the security was not held on the previous regular interest payment date the refund requested would be based on the period the tax-exempt entity held security.

(c) It is recognized that where a tax-exempt entity sells bonds, notes, etc., between interest dates with adjustments made for tax withholdings, should such entity include in its certification for the month in which the sale took place a request for refund, such refund might be in advance of the month when the Treasury Department will collect the tax at source. In such instances, these items could be included in the certification for the month in which the regular interest date occurs.

(d) Regarding tax withholding on true discount notes, bills, etc., the method as to how the Government will want this income treated for tax withholding will first have to be determined and, based upon that determination, such amounts could be satisfactorily worked into the certification.

SUGGESTED PROCEDURE FOR THE SMALLER TAX-EXEMPT ENTITIES

The tax-exempt entity would deposit dividend payments, interest payments, etc., from which a 20-percent tax has been withheld in its local bank and simultaneously hand said bank a draft drawn on the Federal Reserve bank as fiscal agent for the Treasury of the United States in the amount of the tax withheld at source from these specific dividend and interest payments, etc. This draft would contain endorsements similar to the following:

(a) "By endorsement of this draft the drawer certifies—

"1. That it holds a good and valid ruling from the Treasury Department evidencing its tax-exempt status.

"2. That the proceeds have been credited to the account of the drawer.

"3. That the amount of the draft does not exceed 25 percent of the total interest and dividends, etc., from which tax has been withheld at source, which has been credited to the drawer's account simultaneously with this draft."

(b) "By endorsement of this draft the bank certifies—

"1. That the amount of interest, dividends, etc., noted above have been credited to the account of the drawer."

Discussions with the various tax-exempt entities indicates that use of this refund procedure would be a method preferable to the proposal contained in H. R. 4473 whereby entities able to do so could offset the tax withheld from dividends and interest against the tax withheld from wages, etc., and funds held for social-security payments.

It seems inconceivable that the Treasury Department would think along lines of paying out millions of dollars in refunds without first having something in hand to substantiate same. Therefore, it is seriously doubted that the final

WITHHELD TAX REFUND DRAFT

New York ______ 19___ 1-120/210

Pay to the Order of
for Account of

$ ______

______ Dollars

TO - Federal Reserve Bank of New York
Fiscal Agent for
Treasurer of the United States

______ Authorized Signature

By Endorsement of this Draft the Drawer certifies
1-That it holds a good and valid ruling from the Treasury Department evidencing its tax-exempt status
2-That the proceeds have been credited to the account of the Drawer.
3-That the amount of this Draft does not exceed 25% of the total interest, dividends, etc. from which a 20% tax has been withheld at source and which have been credited to the account of the Drawer simultaneously with this Draft.

Dividend, Interest Payments, etc. Received From	Amount of Dividends, Interest etc. deposited simultaneously with this Draft 80% of Income Receivable	
Total		
25% of Total - Tax Refund also the amount of this Draft		

______ Authorized Signature

By endorsement of this Draft the Bank certifies that the amount of Interest, Dividends, etc. listed above have been credited to the account of the Drawer.

______ Authorized Signature

decision of the Treasury Department will be to make refunds solely on the basis of requisitions. Unless a method is adopted similar to the refund procedure, there will be, of necessity, a long delay in the payment of refunds due to the time required to enable the Treasury Department to ascertain that refunds requested are properly refundable.

R. E. DuMont.

30 Rockefeller Plaza, New York City.

Senator Byrd. The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:35 p. m., the committee recessed to reconvene at 10 a. m. Thursday, August 2, 1951.)

REVENUE ACT OF 1951

THURSDAY, AUGUST 9, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312 Senate Office Building, Senator Harry F. Byrd, presiding.

Present: Senator Byrd (presiding), Johnson (Colorado), Hoey, Kerr, Frear, Millikin, Martin, and Williams.

Also present: Elizabeth B. Springer, chief clerk, and Colin F. Stam, chief of Staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. The committee will be in order.

Congressman MORANO. You may be seated, Congressman.

STATEMENT OF HON. ALBERT P. MORANO, A MEMBER OF THE HOUSE OF REPRESENTATIVES FROM THE FOURTH CONGRESSIONAL DISTRICT OF THE STATE OF CONNECTICUT

Mr. MORANO. Mr. Chairman, first of all, I wish to express my gratitude to the Senate Finance Committee for giving me the opportunity to appear here in behalf of a very important industry in my district. This industry is the electric shaver manufacturing industry, and it employs between 2,000 and 2,200 men and women, some of whom are members of labor organizations, and other white-collared workers.

The revenue act as passed by the House, includes an excise tax on the manufacture of electric razors in the classification of electric appliances.

On May 14, 1951, the House Ways and Means Committee voted to include electric shavers as taxable electrical appliances. I was disturbed by that vote for the reason that I believe it was discriminatory in that it did not include other appliances of a nonelectric nature such as safety and straight razors.

So I approached several members of the House Ways and Means Committee, and pointed out that fact to them. As a result of that, on May 24, 1951, the House Ways and Means Committee again voted on the question of taxing razors, and voted to include safety razors and other types of shaving equipment as taxable.

On June 14, 1951, the question was again raised in the committee, as a result of the committee's having voted to include all razors, and some influence unknown to me brought about the reconsideration of the entire matter.

The House Ways and Means Committee on June 14 began to vote on the matter again.

Having reached one section of the bill which had this language in it, they voted to rescind the action they had taken on May 21, thereby eliminating safety razors and other shaving equipment from taxation.

I understand that before they could reach the question of electric razors, a dispute and a wrangle broke out and nothing was done about eliminating that discriminatory feature from the tax bill.

As a result it came to the floor of the House of Representatives with a provision that would tax the electric shavers. As you gentlemen know, under the rules of the House, as this bill was reported, the rule precluded the offering of an amendment to correct this discriminatory feature; consequently, I was unable to do anything more about it, except to follow the only recourse and come before your committee and ask for relief.

It is my contention that the imposition of an excise-tax on electric razors, sometimes called electric shavers, is discriminatory and will create an unfair competitive position and situation in the razor industry in favor of safety razors and the straight razor segment of that industry.

This is not the first time that this matter has come before the Congress. In 1941, a similar recommendation was made by the Treasury Department with respect to excise taxes in the 1941 Revenue Act on electrical appliances.

An excise-tax on electric razors was included in the bill reported by the House Way and Means Committee, passed by the House and was amended in the Senate to exclude electric razors; went to conference and on the conference report the House receded.

Consequently, electric razors were not subject to the imposition of excise taxes in World War II. In order not to discriminate and not to create an unfair competitive situation, logic would impel the inclusion of all razors or none.

For example, in the 1941 Revenue Act, the Treasury Department recommended an excise-tax of 10 percent upon the manufacture and sale of electric appliances. I quote from the Senate report of this committee No. 673:

> The House bill imposes a tax of 10 percent upon the manufacture and sale of electric appliances. It was pointed out that the exclusion of gas and oil water heaters and cooking appliances, created an unfair competitive situation. Consequently, these gas and oil appliances are included in the tax category and are taxed at the 10-percent rate.

Electric gas and oil appliances were included in the bill as enacted.

I just want to refer you to a statement from Assistant Secretary John L. Sullivan, who spoke to the committee in regard to the proposed new excise-tax, in a prepared statement appearing on page 50 wherein he said:

> In the field of excise taxation it is proposed that a number of new taxes be imposed and the rates of some existing taxes be increased.

This is the important thing he said—he said:

> We have endeavored to avoid excise taxes which would fall on the basic necessities of life—

and certainly a shave is a basic necessity of life.

Senator FREAR. Electric shaver?

Mr. MORANO. Electric shaver, and I will point out why I believe it to be so. There are blind veterans and older people who cannot shave with a straight razor or a safety razor and necessarily must use the more effective and safer electric razor.

Senator FREAR. What percentage of the blind and old use electric razors now?

Mr. MORANO. Well, I am not sure I have that figure, but if I do find it, I will put it in the record.

Senator FREAR. All right.

Senator MILLIKIN. Let me ask you this. Do you think that shaving itself is a basic necessity? [Laughter.]

Mr. MORANO. I think that in this modern civilization, shaving might be considered a basic necessity.

Senator WILLIAMS. At least it is not a luxury, is it?

Mr. MORANO. It is not a luxury, no; certainly not. Now there was a colloquy between Representative Woodruff and John Sullivan. I will not go into it in detail, but I just want to read Sullivan's reply to a question directed to him by Mr. Woodruff, "As long as the other fellow in the same line of business is paying the same tax, I believe it is so," applying to equity and so on.

A formal statement by Colin Stam, the chief of staff of the Joint Committee on Internal Revenue Taxation, before the House Ways and Means Committee made six points as a fundamental test to be considered in the sound manufacturers' tax. I will not read all six of them, but I will read one of them. It said, and this is No. 4, "The tax must be imposed uniformly and without discrimination."

This is explained by saying that it was the desire of each member of a competitive group that he pay taxes upon substantially the same base as his competitor.

Now, certainly I represent a district; I have the great honor to represent a district in the great State of Connecticut, that manufactures about 85 percent of all the electric shavers that are made in the world.

In addition to its being incumbent upon me to appear before this committee in an attempt to adequately represent my district, I think that the principle involved here is important.

The distinguished Senator from Virginia made a very profound observation yesterday in which he was quoted as having said that we are scraping the bottom of the barrel so far as present taxation methods are concerned—in other words, orthodox methods of taxation.

I think that this provision in the House bill is basically an unorthodox method of taxation, because it would tend to destroy competition, and in the question of my district, it would unstabilize employment very much in an important segment of the industry in my district, and harm the economy of my district, including the peace and tranquility and prosperity of many laboring people.

Furthermore, I want to say to you gentlemen that electric shavers are used by women. I am sure that you will agree with me that we Members of the Congress do not wish to further incur the wrath of women.

The legislation in the House, as passed in the House, provides that hair dryers should be taxed. I think you are going a little bit too far if you tax the hair dryers and then tax their electric shavers. [Laughter]

To get down to the revenue involved in this provision, it is estimated that a 10 percent tax imposed on the manufacturer of razors and razor blades in the whole razor industry would result in the collection of $6 million in taxes as compared to only $2 million if you just tax the electric shaver.

The consequence of this discrimination in the razor industry is apparent, both as to competition and as to tax revenue.

Excise taxes paid by the electric razor segment of the razor industry upon a commodity which is recognized to be not a luxury item any more than is a safety razor or a straight razor, should be taxed upon the same base as its competitor manufacturing safety razors or straight razors, otherwise the tax is not imposed uniformly and without discrimination, which is what Colin Stam's statement—what the House Ways and Means Committee said.

Here is the practical matter which I respectfully urge you Senators to consider. If this language is not changed in the bill there is no disagreement in the language when it goes to conference, and if it goes to conference, there is no basis for a discussion of whether or not it is fair and without discrimination and there is no basis for the Senators to determine what the House's reasoning is in imposing this kind of a tax.

Senator MILLIKIN. How much revenue do they expect to get out of it?

Mr. MORANO. It is $2 million.

I urge you that there are two ways of getting it into conference; one, to strike out the language, or, two, to strike out the language and include all razors so that there is a difference between the Houses and a discussion is permitted.

That closes my statement. I respectfully urge, in view of the small amount of revenue to be raised and the most important principle involved, that we not forsake or leave the principle of fairness and justness—open the door to a creeping-in of violations of that principle. We should not do that, in my opinion.

With that, Mr. Chairman, I conclude my statement.

Senator BYRD. Thank you very much.

Mr. MORANO. If I may make a brief statement, I am a great opera lover, and I understand that the Metropolitan Opera people are here, and I would respectfully urge that the tax-exemption language that was inserted in the House bill be retained in the interest of culture and happiness to so many people of the United States.

Thank you very much.

There will be inserted in the record a letter from Senator William Benton, a letter from Francis J. McNamara, general counsel of the Remington Rand Co., and a proposal to amend section 127 of the code, relating to foreign-war losses submitted by the Gillette Safety Razor Co.

(The letters referred to follow:)

UNITED SATES SENATE,
Washington, D. C., August 2, 1951.

HON. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: It is my understanding that your committee is considering a luxury tax upon electric razors. This is contained, I understand, in the House tax bill.

It has come to my attention that originally in this House bill all types of safety shaving devices were taxed, but that the tax on all but electric razors was removed by the House.

I have been told that you had the same problem a few years ago and at that time the committee removed the tax also upon electric razors. I hope that your committee will be able to do something about this discriminatory tax as it stands in the House bill so that all razors are either taxed equally or not taxed at all.

You may be interested to know that 85 percent of all the electric razors in the United States are made in my State of Connecticut. Thank you very much for any consideration you are able to give this matter.

Very sincerely yours,

WILLIAM BENTON,
United States Senate.

REMINGTON RAND, INC.
New York, N. Y., August 1, 1951.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

MY DEAR SENATOR: Enclosed is a copy of a letter which I have today sent to Elizabeth B. Springer, chief clerk of the United States Senate Finance Committee.

I am advised that the hearing will be held on August 2 with respect to the phase of the Revenue Act which imposes a 10-percent manufacturers' excise tax on "electrical appliances," including electric razors.

I ask that you give your usual careful consideration to the position taken by this company with respect thereto.

Respectfully,

FRANCIS J. MCNAMARA,
General Counsel.

AUGUST 1, 1951.

SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.
(Attention Elizabeth B. Springer, chief clerk.)

GENTLEMEN: The revenue act as passed by the House includes an excise tax on the manufacture of electric razors in the classification of electric appliances.

The chronology of the action of the House Ways and Means Committee was as follows:

May 14, 1951, voted to include electric shavers as taxable electric appliances.

May 24, 1951, voted to include safety razors and other types of shaving equipment as taxable.

June 14, 1951, action of May 24, 1951, rescinded. The revenue act as it passed the House provided for an excise tax of 10 percent on electric appliances including electric shavers.

It is my contention that the imposition of an excise tax upon electric razors (sometimes called electric shavers) is discriminatory and will create an unfair competitive situation in the razor industry in favor of the safety and straight razor segment thereof.

A survey by American Legion magazine reflected—

	Percent
Type razor used: [1]	
Safety	81.3
Electric	23.3
Straight	4.4

Shaving habits—Makes of razors used:	
Safety:	
Gillette	48.1
Schick	18.0
Gem	7.1
Rolls	1.0
Electric:	
Remington Rand	8.3
Schick	7.4
Sunbeam	5.4
Others	4.3
No preference	.4
	100.0

[1] Adds up to more than 100 percent because of multiple mention.

Remington Rand, Inc., as you will observe from the above survey, will be affected by the imposition of a 10-percent excise tax as included in the bill as it passed the House, and together with other manufacturers of electric razors, will be the subject of discrimination through the exclusion of other makes of razors, creating an unfair competitive situation.

A similar recommendation was made by the Treasury Department with respect to excise taxes in the 1941 Revenue Act, on electric appliances. An excise tax on electric razors was included in the bill reported by the House Ways and Means Committee; passed the House; was amended in the Senate to exclude electric razors; went to conference, and on the conference report the House receded. Consequently, electric razors were not subject to the imposition of excise taxes in World War II.

In order not to discriminate, and not to create an unfair competitive situation, logic would impel the inclusion of all razors, or none. For example in the 1941 Revenue Act, the Treasury Department recommended an excise tax of 10 percent upon the manufacturers' sale of electric appliances. I quote from the Senate Report No. 673:

"The House bill imposes a tax of 10 percent upon the manufacturers' sale of electric appliances. It was pointed out that the exclusion of gas and oil water heaters and cooking appliances created an unfair competitive situation. Consequently these gas and oil appliances are included in the taxable category and are taxed at the 10-percent rate."

"Electric, gas, and oil appliances" were included in the bill as enacted.

Relevant portions of the legislative history of the 1941 Revenue Act follow:

(*a*) The Treasury opened the hearings before the House Ways and Means Committee (77th Cong., 1st sess., revised vol. 1). After Secretary Morgenthau testified, Assistant Secretary John L. Sullivan spoke to the committee in regard to the proposed new excise taxes in a prepared statement appearing at page 50, he said (inter alia):

"In the field of excise taxation it is proposed that a number of new taxes be imposed and the rates of some existing taxes be increased. *We have endeavored to avoid excises which would fall on the basic necessities of life* and excises which, while productive, would constitute an increase in the cost of doing business and thus would be passed on to the Government and to the public in general price increases. *We have, however, selected certain luxury articles which, though widely used, are not necessities.* It is suggested that in the light of our over-all revenue requirements the users of these articles may now be asked to pay additional taxes. The list of these excises is limited by the difficulty of finding commodities consumed in sufficient quantities to bring in revenue commensurate with the expense of administration. Undoubtedly the committee will want to consider the possibility of adding other commodities to the list." [Emphasis supplied.]

After this formal statement Representative Woodruff questioned Sullivan on the matter of corporate taxes. The principle involved, is in my opinion, worth mention in relation to certain statements herein following by Colin F. Stam, Chief of Staff, Joint Committee on Internal Revenue Taxation, at page 72:

"Mr. WOODRUFF. Well, now, Mr. Sullivan, referring to the corporation taxes; competition in this country is rather keen, is it not, between different businesses of like kind?

"Mr. SULLIVAN. Yes, sir; I think that it should be.

"Mr. WOODRUFF. And when taxes are placed on corporations, that does not in any degree, does it, change the competitive-business conditions as between the different competitive organizations, if the law is applied to all alike?

"Mr. SULLIVAN. There might be some situation in which it did, but I cannot think of them. I would say generally the answer is "No."

"Mr. WOODRUFF. That is my opinion, and as a matter of fact, it is not a matter of some indifference, not complete indifference but some indifference, to corporations as to how high the tax placed on them is, so long as they know exactly what that tax is?

"Mr. SULLIVAN. *As long as the other fellow in the same line of business is paying the same tax, I believe that that is so.*" [Emphasis supplied.]

(*b*) Formal statement of Colin F. Stam, Chief of Staff of the Joint Committee on Internal Revenue Taxation, before the Ways and Means Committee pages 82 and 87:

"The Committee on Ways and Means set up, as six fundamental tests of a sound manufacturer's tax, the following (Rept. No. 708, 72d Cong., 1st sess.):

"(1) The rate should be low, so that undue burdens will not be imposed.

"(2) Certainty, both as to liability and amount, must be attainable in advance of sale.

"(3) Pyramiding must be prevented.

"(4) The tax must be imposed uniformly and without discrimination.

"(a) This is explained: 'It was desired that each member of a competitive group pay tax upon substantially the same base as his competitors.'

"(5) Provisions must be made for the least administrative difficulty (such as classifications arising in connection with exemptions).

"(6) Adequate authority must be granted to assure a sound, smoothly functioning, and flexible administration."

In considering the House bill, I ask that you give due weight to the factors presented in the enclosed statement of Mr. H. C. Landsiedel, manager of the Shaver division of Remington Rand, Inc., which employs approximately 1,200 persons in the manufacture of electric shavers, which are now sold at retail in almost every city and town in the United States.

I invite your attention specifically to Mr. Landsiedel's estimate that the same tax of 10 percent imposed upon the manufacture of razors and blades in the razor industry would result in the collection of $6,000,000 in taxes as compared to $2,000,000 available from the manufacture of electric shavers. The consequence of the discrimination in the razor industry is apparent; both as to competition and taxes.

Excise taxes paid by the electric-razor segment of the razor industry upon a commodity which is recognized to be not a luxury item any more than is a safety razor or a straight razor should be taxed upon the same base as is its competitor manufacturing safety razors or straight razors. Otherwise the tax is not imposed uniformly and without discrimination.

Respectfully,

FRANCIS J. MCNAMARA, *General Counsel.*

BRIDGEPORT, CONN., *July 27, 1951.*

Memorandum: In connection with the proposed manufacturers excise tax as it relates to electric shaving.

The law as proposed represents, in our opinion, a discriminatory measure against at least 25 percent of shaving men in America, who over the past 15 years have been converted to this modern, speedy method of performing what is to all of us a social necessity in the American way of life.

The figure of 25 percent set forth above is not a figure used glibly without substantiation. Detailed below are four of several surveys conducted by independent organizations showing the percentage of use by the shaving public of electric shavers.

	Percent
City of Spokane, Spokane Spokesman's Review	30.7
City of Seattle, Seattle Times	32.2
City of St. Paul, St. Paul Dispatch and Pioneer Press	24.3
City of Sacramento, the Sacramento Bee	24.3

The percentages expressed above are, of course, percentages of consumers using an electric shaver and all of the analyses were made during 1950.

A survey just issued by Drug Topics, in their issue dated July 30, 1951, shows that civilian retail spending for electric shavers in 1950 was $45,404,000. This figure is considered by some manufacturers to be excessive and they conservatively place the amount of retail spending for electric shavers at $40,000,000. On the basis of the present discounts in the trade, one-half of this sum goes to the manufacturer, or about $20,000,000, upon which the Government, on the basis of the proposed excise tax, would collect something less than $2,000,000.

In the same survey retail sales of razors and blades are estimated at $10,049,000 and $95,571,000, respectively, a total of $105,620,000, of which approximately $60,000,000 goes to the manufacturer; and were razors and razor blades included in the proposed law, $6,000,000 in taxes would be collected.

Obviously, from the above figures, the proposed law would collect $2,000,000 by taxing the electric dry shaver and forego a tax of $6,000,000 by not taxing the razor and razor-blade industry.

If the users of dry shavers represented 6, 5, or 10 percent of the total shaving public, the percentage of users would, obviously, be in the minority. The situation is, however, exactly the opposite, 25 to 30 percent of the shaving public use the dry-shaving method.

Actually, retail sales of shaving products of all kinds represents a $255,000,000 industry, of which the dry shaver represents $45,000,000 and, in addition to razors and blades, there is about $95,000,000 spent for lathers, soaps, powders, lotions, strops, etc. If we understand the proposed law, none of these items have been included in the excise tax.

A poll of the Members of the Congress quite possibly would show that at least 25 percent use dry shavers. Surveys to the general public by outstanding publications such as American Legion magazine, Collier's Weekly, Milwaukee Journal, confirm the percentage figures of 25 to 30 percent.

The most recent survey which has come to light has just been published by Boy's Life, the national magazine published by the Boy Scouts of America, and the survey shows that 24 percent of the boys who shave between the ages of 13 and 18 use the dry-shaving method. Hundreds of thousands of boys and young men, who have started shaving since 1935, have never used a razor blade.

The dry-shaving industry received great impetus during and after the war from men in the services. As a matter of fact, during World War II priorities were issued to enable servicemen not only to continue to use the dry-shaving method but to progress to this new, modern method. The dry shaver has been a boon of inestimable value to veterans' hospitals, where disabled veterans have been afflicted with face wounds. Thousands upon thousands of individuals can use only the dry-shaving method because of skin disorders and the fact that the nature of their skin is such that it cannot be subjected to the daily scraping of a knife.

In many instances the electric dry shaver has been maligned as a luxury item. Incontrovertible proof exists to dispel this allegation. Actually, the initial cost of the electric shaver is the only major expense involved. Consolidated Edison Co., of New York, has stated publicly that shaving by electricity consumes only 5 cents worth of electricity in 4 years. The average life of a good electric dry shaver is between 4 and 5 years and, during the same period, the average man using a safety razor will consume a minimum of 400 razor blades, 48 tubes of shaving cream, 48 bottles of shaving lotion, and possibly several styptic sticks.

Actually, the end use of critical materials, such as steel, in the dry shaver is considerably less than that of wet shaving. The amount of steel in one electric shaver approximates 7.8 ounces—whereas the safety razor together with a blade approximates 1.7 ounces. The amount of steel consumed in 400 razor blades is 45.5 times greater than that used in an electric shaver.

The main purpose of an excise tax is to produce revenue for the Government without discrimination. Dry shavers are sold in drug, jewelry, hardware, and department stores.

They are used by men in all walks of life—professional men, businessmen, farmers, laborers, etc.

They are a necessity for the blind, for many of our maimed veterans, for the aged, who can no longer trust themselves to use a sharp razor with their weakened reflexes. Some manufacturers have gone out of their way to present reconditioned dry shavers to thousands of our blind veterans and has serviced, gratis, shavers for the men overseas for the past 10 years.

It is an industry that is growing and, in my opinion, an excise tax against them at this time is discriminatory; it would also be an additional burden in cost for 25 percent of our men—and, it would definitely retard an industry that is now providing a healthy revenue in income tax to the Treasury Department that would be substantially diminished by imposing on it this excise tax.

H. C. LANDSIEDEL,
Manager, Shaver Division, Remington-Rand, Inc.

A PROPOSAL TO AMEND SECTION 127 OF THE CODE, RELATING TO FOREIGN WAR LOSSES

This memorandum is submitted on behalf of Gillette Safety Razor Co. in regard to section 127 of the Internal Revenue Code. Section 127 deals with the tax treatment of war losses and the recovery of such losses. This memorandum recommends an amendment of that section which would eliminate a serious inequity.

Generally speaking, section 127 authorized a war loss deduction for property in enemy hands when the United States entered the war in 1941. This deduction was, of course, limited to the taxpayer's cost of the property. However, section 127 also provided that if any of the property was recovered, the fair market value of the recovered property—not the amount deducted—was to be taxed as ordinary income to the extent that the deduction resulted in a reduction of tax.[1] In addition, section 127 set forth a governing rule where the war losses embraced more than one property. In that case the war losses of all the properties were to be treated as a single deduction, and any later recovery of a particular property was to be taxed at its fair market value to the extent that the over-all eduction reduced the tax. In other words, if a recovered property was worth more than the deduction previously taken for the same property, the difference was to be taxed as ordinary income merely because the taxpayer took a war loss deduction on some other property which was not recovered. As a result, section 127 produced very harsh tax consequences.

These harsh results are well illustrated by Gillette's situation. In 1941 Gillette had properties in a number of invaded European countries, and hence took war loss deductions in computing its 1941 tax. These deductions were based on Gillette's cost of the properties, and were as follows on a country-by-country basis:

Properties:	Deduction
Germany	$2,471,510.07
Poland	53,954.24
Netherlands	51,200.00
Belgium	76,648.07
Denmark	395,240.85
Italy	451,906.07
Norway	24,259.88
France	640,040.26
	4,164,764.94

In 1945 Gillette recovered these properties except those located in Germany and Poland. As indicated above, the German and Polish properties were represented by a deduction of $2,525,464.31 and the other properties by a deduction of $1,639,300.63. On the basis of section 127 the Bureau now holds that the aggregate fair market value of all the recovered properties in 1945 was not less than the total war loss deduction of $4,164,764.94, and therefore proposes to treat the $4,164,764.94 as ordinary income to Gillette for 1945 because in 1941 there was a total war loss deduction in the same amount.

We respectfully submit that this result is extremely unjust. Obviously the net effect of the recoveries in 1945 was that Gillette had only reacquired its properties in the Netherlands, Belgium, Denmark, Italy, Norway, and France, for which it had deducted the much smaller amount of $1,639,300.63, representing Gillette's remaining cost for those properties. At the same time the German and Polish properties, representing an aggregate deduction of $2,525,464.31, were still unrecovered. In short, at the end of 1945 Gillette had recovered less than 40 percent of its investment in the properties involved, but the company is now being taxed as if it had recovered its entire investment. Or to put the matter differently, section 127, as it now stands, taxes the mere appreciation in value of a recovered property merely because of a deduction taken on some other unrecovered property which still constitutes a loss. Needless to say, it is a basic principle of income-tax law that gains are not taxable until they are realized, and a mere appreciation in the value of property is a far cry from a realized gain.

Section 127 sanctions such harsh results because it taxes the fair market value of a recovered property rather than the lower cost of the property previously deducted. Several years ago the Treasury agreed that section 127 operated unfairly and therefore requested this committee to amend the statute. In a letter dated February 26, 1948, addressed to the chairman of the committee, Under Secretary Wiggins wrote:

It is recommended that the present income-tax treatment of war loss recoveries be revised and that there be substituted a rule under which the tax upon recovery of property for which a deduction was taken should be equal to the tax saving that resulted from the related deduction. In the interest of administrative simplicity the recommended revision would also eliminate the present rule requiring all property recovered to be aggregated in determining the tax

[1] In this connection sec. 127 established a number of rules for the situation where only part of the war loss deduction reduced the tax. For present purposes these rules need not be considered.

upon recovery and would provide that recovered property be taken in either at its former adjusted basis or the fair market value, at the election of the taxpayer."

As the Treasury has pointed out, the injustice discussed in this memorandum may be easily eliminated by providing that the taxable amount on a recovery is the fair market value of the recovered property or the previously deducted cost, whichever is lower. On the other hand, the committee may consider it more desirable to recompute the tax for the loss year by treating any recovered property as if it had been recovered in the loss year. Under this alternative, the recovery would similarly be taken in at its undepreciated cost on the date of loss or its fair market value on the date of recovery, whichever was lower.

Senator BYRD. Mr. Blair.

STATEMENT OF FLOYD G. BLAIR, PRESIDENT AND TREASURER, THE PHILHARMONIC SYMPHONY SOCIETY OF NEW YORK

Mr. BLAIR. I am afraid, Mr. Chairman, that I have to briskly take the committee from the realm of hair into the realm of music. That illustrates the versatility of Congress.

Mr. Chairman, I am the president and treasurer of the Philharmonic Symphony Society of New York. In my private capacity I am vice president of the National City Bank of New York. I am here to discuss the impact of the Federal admissions tax of 20 percent on charitable nonprofit organizations such as symphony orchestras.

In order to conserve the time of the committee, I have been requested to represent a number of the other major symphony orchestras of the country, as well as our own philharmonic symphony in New York.

Mrs. Thompson, of the American Symphony Orchestra League, who will follow me, will tell you something of the problems of some of the smaller orchestras of the country.

Senator BYRD. Mr. Sloan is going to testify, too, for the Metropolitan Opera and he follows you.

Mr. BLAIR. Yes. Mrs. Thompson will follow after that.

I shall try to be brief but, as the interests of millions are deeply affected, I do want to try to call your attention as forcefully as I can to several important facts.

At the outset, I would like to say, Senator Byrd, it is a great pleasure for me to appear before this committee again.

When I was in the Treasury 25 years ago, acting as legal adviser to Secretary Mellon, from time to time I had the honor of appearing here with him.

Senator Smoot was then chairman. I am sure that all of you can understand how thrilled I was when, under a special rule, I was allowed the privileges of the floor, and for some weeks, when the war debt settlements were under discussion in 1926, sat on a small seat between Senator Smoot and Senator Lenroot, right in front of Senator Borah and Senator Norris. It was an unusual experience for a young man in those days, and made a deep and lasting impression on me.

In the interest of brevity, and to save your time, I cannot go into great detail. I am going to push on as fast as I can.

Without going into personal details, I assure you that no one is more deeply concerned than I to see that the finances of our Government are kept on a sound basis, and that serious inflation is avoided, and that the value of the dollar is maintained.

While I realize that it is not the direct responsibility of the Finance Committee to control the expenditure of money by the Government, working with the Ways and Means Committee of the House of Representatives, it is your duty to see that the required funds are available and, in so doing, to safeguard as best you can what this country has fought for and cherished, generation after generation.

Certainly, there is no group of public officials here in Washington with a higher sense of responsibility than this committee.

The people of the United States have the greatest confidence in the sound judgment and high purpose of your distinguished chairman, Senator George, and of the other members of this committee, and know that each one of you may always be counted upon to do what is wise and best for the country as a whole.

When the tax bill was before you a year ago, I filed a statement with the committee giving many detailed facts about symphony orchestras and orchestral groups across the country. That statement appears on pages 131 to 135 of the hearings before this committee a year ago on H. R. 8920.

I am not going to refer to those detailed figures again, and I do not propose to file any new ones with you.

However, I have filed with the committee a simple condensed budget of our own orchestra, which I trust is before each one of you. It is at the outset of my statement. This was prepared during the course of the past concert year, and was filed with the Ways and Means Committee when I testified before it last March.

Our budget in New York is typical of the budgets of the other major symphony orchestras, except that relatively our position, though bad, is better than that of most. This is because the Philharmonic Symphony Orchestra has a much larger income from radio broadcasting than any other orchestra, and a greater income from record royalties than all other orchestras with the exception of the Boston Symphony Orchestra and the Philadelphia Orchestra.

Now, a word with respect to the Philharmonic. The Philharmonic Symphony is the oldest symphony in the country. We just closed our one hundred and ninth season, as a matter of fact.

We have more than 7,000 regular ticket subscribers. During the season our audiences in the concert hall number more than a quarter of a million. On Sunday afternoons our concerts are broadcast throughout the Nation, attracting from 10 to 15 million listeners to each concert.

Individuals from every State in the Union have become radio members of the society, and countless thousands buy more than a million of our recordings each year.

In addition to regular concerts, we also conduct a series of concerts for young school children, and another for the older high-school group.

During the summer, operating through a separate organization known as the Stadium Concerts, concerts are given at the Lewisohn Stadium to audiences, in New York, running from 300,000 to 500,000 for the series.

This year, in August, the orchestra will go to Scotland where it will be the mainstay of the Edinburgh Festival from August 22 to September 24, all our expenses being paid by our Scotch friends.

The fundamental facts of a symphony orchestra are known to all of you. They all operate at a loss, differing only in the size of the deficit.

Formerly our deficits were met year after year by large donations chiefly from a few public-spirited citizens of great wealth. Due to the impact of taxation, such donations have shrunk to the vanishing point.

In our estimated budget for the season just closed, you will note that we have a deficit from operations of something over $200,000 and a final deficit of $150,000.

Despite the fact that the society is a purely cultural, educational organization, certainly not operated for profit, nor experiencing a profit, it was required to collect from its subscribers and purchasers of tickets and pay over to the Federal Government admissions taxes aggregating just under $110,000.

Mr. Chairman, this is a burden which we and many other orchestras of the country can no longer sustain. If you wish us to continue to exist, it is vital that our former exemption be restored to us, and restored without delay.

In addition to the larger orchestras, there are probably 20 to 25 minor symphony orchestras in the country, which are in a relatively much worse position than we. Beyond them, come, perhaps, 600 school, semiprofessional, and amateur orchestras scattered across the country, mostly in smaller communities.

These are made up from 60 to 100 players who, with their families, represent a cross section of American life at its best.

There are also probably more than 2,000 community and civic concert groups operating all over the United States. Series of concerts are organized and our best artists are brought before audiences in cities and towns, large and small, from North to South and East to West.

Audiences in these concert halls number many millions. The radio audiences for the Philharmonic and for the opera add millions more. Millions of recordings of our great orchestras are sold each year, and are played at home and by our radio stations over and over again.

During the summer, countless millions of music lovers sit under the stars and drink in great music from orchestra after orchestra from the Hollywood Bowl of southern California, with an audience of 25,000 people, to the Lewisohn Stadium in New York with audiences running from ten to twenty thousand.

The distinguished Senator from Colorado can tell us about the summer concerts which mean so much to the people in Denver and the Rocky Mountain area, and which draw thousands to a natural amphitheater of red rocks nestled at the edge of the towering Rocky Mountains.

And of course, there are numerous music festivals, such as the famous Berkshire Festival in Massachusetts, which for weeks draw music lovers, teachers, and students to their respective centers.

What does all this mean to the American people? Is good music something they need? Is it something that in times of stress and anxiety people had better do without? Is it something we should deny our youth? Is it something which should be grouped with the movies and perhaps, prize fights and night clubs, or is it part of the cultural heritage of America, something that touches the soul, something which with many approaches the realm of religion?

If you have any doubt as to the answers to these questions I can quickly resolve them.

As I have said, each Sunday during the concert season we broadcast to the Nation. A hundred radio stations carry broadcasts. Each Sunday we appeal to the radio audience for help. We receive thousands of letters from people all over the country, and in all walks of life.

As so often happens, those who can least afford it, make the greatest sacrifice to help us. I am going to read you a few excerpts from just one or two of these letters. I hope they will remain in your minds when you consider our problem.

The first is from a listener in California.

So far back as I can remember, no Sunday was complete without the New York Philharmonic Broadcast. If only more such programs were available to the public, how much fuller our lives would be.

This is from a listener in Erie, Pa. It came in some months ago, apparently just after the individual arrived in the United States.

Every Sunday afternoon I listen with pleasure to your fine programs. Since I only live in America for 4 weeks, I couldn't become a member of your society earlier. I regret deeply that I cannot give you more than this one single dollar.

A worker in St. Meinrad, Ind., wrote as follows:

Being a workingman here at the abbey, and also having several other good causes toward which I regularly contribute, I cannot send to you the amount I should like to. Even so, I could never begin to show you, even in terms of money, how much your fine orchestra means to me and to all of us who listen.

He sent us $1.

From upstate New York:

If I did not send you this $1 I would feel I had stolen my way into Carnegie Hall today. I keep an envelope in which I place names and addresses of things religious and otherwise which I appreciate, and would like to help with my limited means. I am now a retired teacher.

From Detroit, Mich.:

I am 12 years old and a violinist in the Jewish Center Symphony Orchestra. I listen to your broadcast every Sunday when I get home from rehearsal. The New York Philharmonic Symphony Orchestra is not only a national institution, it is a household word. It would be a great loss to America were it to disband. This dollar I am sending is in memory of the ill-fated Detroit Symphony. Please enroll me as a radio member of the society and send me all the paraphernalia that goes with it.

A young boy of eleven wrote from Minneapolis:

Whenever I can I listen to your beautiful music. I am listening to your program as I am writing this letter. I have enough to send you $1.

From Bay City, Mich.:

Please accept my enclosed contribution of $1 to aid in your financial campaign. I am sending all I can afford as I am saving what money I can to finish college at the University of Michigan.

From Telford, Pa.:

We have long cherished your afternoon concerts and hope that they may continue for the benefit of our children who have few opportunities to see and hear fine music performed.

From Chicago, Ill.:

Many of us can afford very little, but the New York Philharmonic has been a vital part of our lives for years, and we look forward to our quiet happy Sundays and the music we love each week as one of the bright spots of our week. My husband is in school and we have a precious baby, so our funds are quite limited.

From Rome, N. Y.:

I am enclosing $1 for the society. Wish it were many times that amount but we have to live upon the salary of a minister of a small church and salaries have not risen with the cost-of-living rise. We love music and hope it can continue.

From Allentown, Pa.:

I've received many thousands of dollars worth of priceless intangibles through the years from your series. Even though a modest pay check does not go far with a wife and two kids, an invalid father and an exorbitant rent, I'd like to do what I can.

From Washington itself:

The enclosed really pinches my budget, but as I am 72 years old, I feel that I cannot afford to let any opportunity pass when I can hear good music.

From a young girl of seven who lives in Cincinnati, Ohio—and I am sorry Senator Taft is not here:

I like the symphony. I am sending a quarter to you.

This young girl sent in 25 cents with a little letter scrawled in her own handwriting and a picture of herself that she drew.

From a mother in Indiana:

I am enclosing this dollar in memory of our son, Patrick who died October 9. He was only 16 years old and never missed one of your broadcasts, if it were at all possible for him to listen. Thank you for the pleasure and beauty you brought into the life of our boy, and I wish the money might be more, but he died suddenly of bulbar polio, and we feel that we should contribute what is possible to the National Foundation.

Now, finally, I am going to read from a letter that came sometime ago from Vancouver, Canada. I shall summarize the first part—it is a little long. This gentleman sent in $1, a United States dollar which he got from his son. Somebody gave his son a United States dollar, and he said he gave him more in Canadian money. It was a birthday gift to his son. He told us that he was suffering from multiple-sclerosis and had been suffering for the past 20 years; that he was living on borrowed time.

He said that fortunately he learned the touch system on the typewriter, and while he had only 8 percent vision, he wrote a letter, which was filled with typographical errors. He still had his hearing. He said:

I have been living on borrowed time for the past 8 years but I differ from the late Lou Gehrig in continuing to wish to live much longer, even in pain.

He said he wanted to live on, and he ended his letter in this way:

So here is my small contribution to your current campaign for support. Would that I might do more, but it is all I can do to keep alive, but life for me is richer and warmer because of a great music which you send to me, and untold thousands more all over this continent. Please do not let this note excite your sympathy. On the other hand, you should congratulate me because I am able to hear, assimilate, and appreciate the diet of great music which you give us all.

Thanking you with a whole heart, I remain,

Yours very truly.

Gentlemen, you have the answer to the question: What does music mean to the people of this country and, I should add, of Canada.

Next, you must answer the question: What should you here in the Finance Committee of the United States Senate do about it?

Do you want us to continue to function? Are we the sort of a charitable, nonprofit organization that should be encouraged, particularly in these difficult dark days which once more have brought grief and despair into so many American homes? Must this great country of ours, sometimes careless in its spending, giving away billions abroad, through unjust taxation smother such organizations, every one of which operates at a loss and struggles to survive through public charity?

I leave the problem with you. I am confident that you will confirm the action taken by the House of Representatives, and see that a wrong is put right, and that justice is done.

The Philharmonic Symphony has just completed 109 years of public service. We have survived five wars and many financial crises.

In all that time, gentlemen, we have missed only two scheduled performances, those caused by the deaths of Abraham Lincoln and the late President Roosevelt. What happens to us and to others like us will be profoundly affected by what you do.

I appreciate, Senator Byrd, the opportunity to appear before you and, of course, shall be glad to answer any questions, if any of you have any to ask me.

Senator BYRD. Thank you very much, Mr. Blair.

Mr. BLAIR. Thank you, sir.

(The budget estimates referred to follow:)

The Philharmonic-Symphony Society of New York budget, 1950–51

ESTIMATED EXPENSES

	Amount	Percentages based on total expenses
Salaries to conductors, orchestra players, extra musicians, extra rehearsals and overtime	$534,000	
Rental of halls and box office	101,500	
Program annotations and printing; printing tickets, subscription notices, advertising and publicity; soloists, choruses for special works, royalties and rental fees for music; all expenses of Young People's and Membership Concerts	128,800	
Expenses incurred by conductors and orchestra, workmen's compensation, insurance of musical instruments, and rent of orchestra room	16,000	
Total direct concert charges	780,300	75
Pension plans, pensions, special activities	134,000	13
Managers, assistants, auditors, staff and rent of offices, telegraph, telephone, postage, and incidental expenses	101,500	10
Radio memberships, booklets, program notes, postage	18,000	2
Total estimated cost	1,033,800	100

ESTIMATED RECEIPTS

Subscription and single sales: Thursday, Friday, Saturday, and Sunday concerts	$570,000	
Young People's series	30,000	
	600,000	
Less Federal admission tax paid to Collector of Internal Revenue	100,000	
Total net receipts from ticket sales	500,000	48
Broadcasting, phonograph recording, program advertising	198,000	20
Pension plans, investments, special activities	102,000	10
Total receipts from above activities	800,000	78
Deficit from operations	233,800	
Investment income	25,000	
Radio memberships, Women's Auxiliary Board and Guarantors' Fund	59,000	
Total	84,000	8
Total estimated receipts	884,000	
Net deficit	149,800	14

Senator BYRD. Mr. George Sloan.

STATEMENT OF GEORGE A. SLOAN, CHAIRMAN OF THE BOARD, METROPOLITAN OPERA ASSOCIATION

Mr. SLOAN. Senator Byrd, and gentlemen of the committee, I appear before your committee as chairman of the board of the Metropolitan Opera Association.

Perhaps, the best way I can show my appreciation for this opportunity of addressing you is to be brief, and I shall be very brief.

In all earnestness and in all seriousness, I wish to state to the committee that if the admissions tax now charged against nonprofit musical organizations is continued, the Metropolitan Opera Association will be compelled to close its doors when we have exhausted the funds from our present fund-raising campaign, which I will describe briefly in a moment.

The Metropolitan Opera Association, gentlemen of the committee, is not a local organization. In addition to approximately 20 weeks of performance given in New York City, we also each year make a tour of from 5 to 8 weeks to other important cities from coast to coast, including the South, Southwest, and indeed all sections of our country.

The broadcasts of our performances in New York each Saturday go out over a national radio system to all parts of the United States and to Canada. And, as in the case of the Philharmonic; they are listened to by many millions of people.

We have tests made each year to see the extent of our radio audience, and this past year the test showed approximately 15 million people.

We receive letters each year from every section of the country testifying to the pleasure and educational value that these broadcasts bring to the homes of countless Americans. Our letters are quite similar to those that have been read to you by Mr. Blair, president of the Philharmonic Orchestra.

We also receive letters of appreciation from music clubs that have been organized as listening groups in many cities, and from music departments of schools and colleges from servicemen in military hospitals and recreational centers.

There have been 70,000 such letters this past season.

Now, despite the full houses, both at home and on tour, the Metropolitan Opera sustained a deficit for the season just concluded, that is, the 1950–51 season of $461,000. That was slightly under the $500,000 paid in Federal admission taxes.

In order to meet the deficit and to provide funds to get the new season 1951–52 underway, we have conducted an intensive drive to secure the sum of $750,000 in contributions from the general public.

This campaign has been carried on over a period of 7 months, beginning last December, and we have utilized every available method of approach, radio broadcasts, benefit performances, personal solicitations, and the campaign is still underway.

If we are successful in reaching our goal the funds derived from this campaign will, in my opinion, be used up under present conditions—at the end of the 1951–52 season.

The greater part of this fund will go toward the deficit of our past season.

I might say, Mr. Chairman, that I have served as chairman of this fund-raising committee, as I have on many other occasions during the past 10 years for the Metropolitan opera. It is a very time-consuming effort, I can assure you. It is a labor of love, as it is with all of our directors, and as in the case of the symphony orchestras the raising of funds becomes more difficult each year.

We have been obliged to beg for these funds since the beginning of the application of the Federal admissions tax.

We are constantly striving to have the Metropolitan Opera recognized as a democratic institution, drawing its patronage, in large measure, from those who love good music, but who are not persons of great wealth.

In this present campaign, for example, there is something over $700,000 that has thus far been contributed—and those gifts average under $10. Approximately a quarter of a million dollars of this money came from our radio audience averaging approximately $3 a gift.

We have made tremendous progress in making the institution more democratic, and we feel, therefore, that any further increase in the cost of our admissions would be harmful.

As an educational institution the Metropolitan Opera is distinguished from theatrical companies that operate for a profit, and has been ruled exempt from the Federal income taxes, from Federal social-security taxes, Federal capital-stock tax, New York franchise tax, New York unemployment-insurance tax, New York real-estate tax, and New York City gross-receipts tax, and occupancy tax, and prior to 1941 it had been exempt from the Federal admissions tax.

I might add, Senators, that we have voluntarily accepted, of course, the Federal social security, and New York unemployment insurance. The point I wish to emphasize is that we are legally exempt from all such taxes.

Many persons compare the plight of opera in this country to that of European countries where opera is supported in whole or in part by Government subsidy.

I know something about that subject, having looked into it carefully.

I was abroad this summer with the International Chamber of Commerce, working on rearmament problems, trying to encourage our business friends abroad to step up their production, and their productivity. A fine meeting we had, gentlemen, in Lisbon, with some 31 nations represented and some 550 businessmen from all over the world.

While over there I looked into some of these musical organizations, and I found in Paris, for example, that the two opera houses, the Opera Comique and the Paris Grand Opera received together slightly over the equivalent of a million dollars in subsidy for this past year.

Now, the Metropolitan has never believed in direct Government subsidy for operating in this country, and we are certainly not seeking it at this time. We submit, however, that there is a definite inconsistency, if not an unfairness, in taxing our own people for opera produced by nonprofit organizations in this country while we, as a nation, at the same time are contributing to the rehabilitation of some of those countries that are continuing to support opera by direct subsidy.

The tax bill as passed by the House, H. R. 4473, in section 402, contains a provision that will exempt the Metropolitan Opera as an educational organization——

Senator MILLIKIN. Mr. Sloan, do you know whether we are via counterpart funds, or otherwise, assisting in the reconstruction of any opera houses that were destroyed in Europe?

Mr. SLOAN. That I do not know, Senator Millikin. I know that such reconstruction is going on.

For example, in passing through Madrid—I was there 2 or 3 days where I had the pleasure of visiting with our Ambassador, Stanton Griffis. Subsequently, I spent an hour and a half with Col. Joseph Hartfield in going through the old Royal Opera House which was paritally destroyed during Spain's terrible civil war when over 2,000,000 people were killed.

An ammunition dump stored inside the opera house blew up during the war, and they are now rebuilding it at a considerable cost. I do not know how it is being financed.

This tax bill, H. R. 4473, as I say, contains a provision that will exempt the Metropolitan Opera and these other nonprofit musical organizations, as an educational organization receiving substantial support from voluntary contributions, from the Federal tax on admissions.

Unless this provision is permitted to stay in the law, gentlemen, not only the Metropolitan Opera but other fine musical organizations, large and small, in other parts of this country, which operate without profit—and there are many such organizations that I have been in close touch with during these difficult times, and have tried to help them as they have helped us—I can say to you positively that many of them will have to go out of business. If that is the case, I feel, and all of us connected with these nonprofit institutions feel, that a vital artistic, educational, and morale-sustaining factor would be endangered at a time when the benefits of its influence are most needed in our country.

Senator BYRD. Thank you very much, Mr. Sloan.

Mr. SLOAN. Thank you, sir, and the other members of the committee.

Senator BYRD. Mrs. Helen Thompson.

STATEMENT OF HELEN THOMPSON, EXECUTIVE SECRETARY-TREASURER, AMERICAN SYMPHONY ORCHESTRA LEAGUE, INC.

Mrs. THOMPSON. Senator Byrd, and members of the Finance Committee, I am very grateful to you as are our orchestras, for this chance to bring to you our problems, and to tell you a little of our work.

As Mr. Blair explained, there are, generally speaking, two groups of orchestras in the country. He spoke of the Philharmonic, which is one of 25 professional symphonies. You might liken them just a little bit to the big league baseball clubs, except that the orchestras do not and cannot operate for profit, of course.

That group of 25 orchestras has an organization, and the chairman of that organization is Mr. Arthur Gaines, manager of the Minneapolis Symphony Orchestra. Mr. Gaines has prepared an additional statement which we would like to file with the committee and give this time over to a little discussion of our community orchestras.

You have been hearing about music in terms of millions of dollars and millions of listeners. Our symphonies, our language, is couched in hundreds and thousands, and it is only by multiplying our total number, which is about 650, that we get into the terms of millions.

Now, these community orchestras exist in every State in the Union. They exist in small towns, hamlets, bigger towns and even the large cities.

Within the membership of this committee, the 11 States, I believe, represented, there are 153 of these community orchestras among your own States.

Ohio alone, has about 38, Pennsylvania 51, and Texas has 32, and so on through the whole group of them.

These orchestras exist largely through volunteer work. Some of you men probably know from personal experience how the people of the community go out and serve as fund-raisers, as administrators, as bassoon players, as fiddle players, in order to have their music.

Senator KERR. You think the fellows who raise this money do it voluntarily?

Mrs. THOMPSON. There is always a question about that, Senator Kerr.

Senator KERR. Do you think it is voluntary to respond to something after the second 50 come in and tell you that if you do not do it, they are going to run you out of town?

Mrs. THOMPSON. If it is for a good cause.

Senator KERR. I understand it is a wonderful cause, but I just want to know if you really think these fund raisers operated voluntarily.

Mrs. THOMPSON. The fund raisers do. Maybe the fund giver does not. [Laughter.]

Senator KERR. Oh, the fund giver has it easy. [Laughter.]

I would be glad to have him pay for what he contributes.

I tell you right now, I want his identity accurately before the committee and before you. I think you have got a wonderful proposition, and I am not sure but that I am for it, but I hate for you to think that I was under the delusion that these fund raisers worked voluntarily. [Laughter.]

Mrs. THOMPSON. Thank you, Senator Kerr.

In addition to raising money voluntarily and playing voluntarily [laughter] our orchestras do a lot of other things. They, of course, play music; that is why they exist, but they link up with all kinds of community activities, which are very interesting.

For instance, out of Pocatello, Idaho, that little orchestra got together and helped send their high school band to the Rose Bowl to play in a concert, to help out, of course.

In Norwalk, Conn., they give free children's concerts. Up in Williamsport, Pa., they take part of their orchestra money and give scholarships to their talented high school musicians, not to study locally, but to go to the best conservatories of the country.

Down in Bluefield, W. Va., in the hills, they do the same thing with their local college.

In the town of Babylon, Long Island, they helped raise money for the polio fund.

Out in Wichita, Kans., they have a young people's or youth orchestra—in fact, two of them—to train them to come up through the group. So, you see, our orchestras can sort of be likened to the sandlot baseball outfits.

Now, gentlemen, in all of these works, we find that the tax, the excise tax, gives us a trio of troubles, financial troubles, which you hear about constantly, psychological troubles, and cultural difficulties.

Senator Martin, Mr. Eugene Reichenfeld, from Wilkinsburg, Pa., who is the conductor of that orchestra over there and also public school music director, sent me a letter recently, and I want to read just a little bit of it because he tells the story even better. He said—

Here in Wilkinsburg we have all worked and slaved for our orchestra for years, because we love it and because our community so desperately needs it, but we cannot surmount this tax problem much longer. This year we raised only $4,000 and for the third year in succession we paid $1,200 in excise taxes. Also for the third year in succession our deficit was $1,200. Financially, we just keep falling farther and farther back, and our people are becoming so disheartened and discouraged over what appears to be a hopeless situation that if we do not get some relief we are going to have to give up our orchestra. And, Mrs. Thompson, he added—

you know that we are not hiring in musicians from all over the place. We take our own Wilkinsburg boys, and girls, and adults and teach them to become symphony musicians. Surely, if our Government understood what we are doing and knew our problems it would feel that our $1,200 would be better spent right here in Wilkinsburg making our city a better place in which to live—providing a finer community in which to raise our children.

Senator KERR. Let me ask you a question on that, Mrs. Thompson. Suppose we cut the tax off, would you raise the price of admission by that amount?

Mrs. THOMPSON. That is just what I wanted to explain, Senator Kerr.

Senator KERR. You do not aim for us to go ahead and collect the tax and give it to you?

Mrs. THOMPSON. No; we would just as soon keep it in the first place.

Senator KERR. I cannot figure out how you are going to be helped by that $1,200 unless either we collect it and give it to you or you raise the price.

Mrs. THOMPSON. This is the way we figure we are going to be helped out. In these smaller cities people will pay only so much money for symphony music, and especially for hometown symphony music. I mean, there is a gross over which they will not go.

Now, if part of that does come into Washington we have that much less to operate with. If part of that does not come into Washington we can just about make it.

Senator KERR. Well, you see, as I understand it, the tax just goes on the admission that you charge?

Mrs. THOMPSON. That is right, but that is 20 percent of our take, gross.

Senator KERR. What you are going to do if the tax goes off is, you are going to increase your admission 20 percent.

Mrs. THOMPSON. We are going to keep the same gross price as it is now. This has been going on——

Senator KERR. I want to say that you are the first one of those who have asked to have the tax removed who has been that fair and frank about it.

I think all of them have been——

Mrs. THOMPSON. Well, that is what will happen, and the reason we feel it is going to help is this: In our community orchestras, the deficits nearly always are equivalent to this tax bill, within just a few dollars.

You will notice that Mr. Reichenfeld mentioned a $1,200 deficit, and a $1,200 tax bill.

In Charleston, W. Va., my orchestra, we had a $1,600 deficit and a $1,675 tax bill.

Grand Rapids, Mich., reports also a deficit between two and three thousand dollars and a tax bill of $2,500, so we feel that in our orchestras if we can keep that gross take, retain that 20 percent, we can just about balance our books.

Senator KERR. You think you can take as much as both you and the Government are taking now?

Mrs. THOMPSON. I am sure of it. For that reason, Senator Kerr, we feel that lifting the tax will be of material benefit to us financially, and it will get rid of discouragement and a feeling of community failure.

This business of its being an obstacle to cultural growth, here is the way that thing works. Some of these orchestras have constituted themselves as closed societies. In that way they do not pay the tax, and everybody belongs to the society. Every society member can go to all rehearsals, concerts, business functions, social functions and all that kind of thing. But not being able to sell tickets means that they cannot do some other things they would like to do.

Senator Hoey, down in Winston-Salem, you have probably heard the story that they want to give concerts and make concerts available to the large colored population of the city.

The Winston-Salem Orchestra is a closed society; they cannot sell tickets, and they are saying, "Would it not be better if we were doing something of this sort than worrying about whether we can or are able to pay a few hundred dollars in excise taxes?"

Gentlemen, these community orchestras serve as a training ground for American instrumentalists, American composers, American conductors. They have to learn their business someplace. They cannot learn it with the Philharmonic, with the Boston, or with the Philadelphia orchestras. They have to know it when they get there.

They learn it with us. It is the place where this tremendous treasury of American music and American talent learns how to operate, and we hope desperately that we can expand those opportunities rather than cut them out.

We are not talking about subsidization. What we are saying is, please do not handicap us, please do not weigh us down; let us retain the total amount that our local people put into these orchestras, and then we believe we can operate without always having our hands out.

I would like to leave with the committee the names of America's 670 orchestras, Mr. Chairman.

It is in the names of all of us that we ask your consideration and hope that we may have relief from the tax.

Thank you very much.

Senator BYRD. Thank you very much.

Mrs. THOMPSON. Senator Byrd, if there are questions about the major symphony orchestras' operations that I cannot answer, Mr. John Edwards, manager of the Washington Symphony is here with me, and will assist.

Senator BYRD. Thank you very much. The papers that you wish inserted in the record will be inserted at this point.

(The prepared statement of Mrs. Thompson, the prepared statement of Arthur J. Gaines, and the list of American symphony orchestras referred to follow:)

STATEMENT OF ARTHUR J. GAINES, MANAGER OF THE MINNEAPOLIS SYMPHONY ORCHESTRA AND CHAIRMAN OF COMMITTEE REPRESENTING 25 MAJOR SYMPHONY ORCHESTRAS OF THE UNITED STATES

My committee has been authorized to present this statement to your honorable committee on behalf of the orchestral associations and symphony societies which maintain major symphony orchestras of the highest quality in 25 cities of the United States. The cities represented are: Atlanta, Baltimore, Boston, Buffalo, Chicago, Cincinnati, Cleveland, Dallas, Denver, Houston, Indianapolis, Kansas City, Los Angeles, Minneapolis, Washington, D. C., New Orleans, Oklahoma City, New York, Philadelphia, Pittsburgh, Rochester, N. Y., St. Louis, San Antonio, San Francisco, Salt Lake City.

First of all, we wish to make it clear that the organizations here represented are maintained solely for artistic and educational purposes; that no symphony association in America is nor ever has been operated at a financial profit; and that we are all dependent on the contributions of private citizens of the communities in which we operate to bridge the annual gap between our earned income and our operating expense.

In recent years, our operating expenses, consisting very largely of the salaries of orchestra musicians, conductors, and artists, have increased by leaps and bounds. Earned income, on the contrary, has remained almost static, due to limitations both in the seating capacities of our concert halls and in the number of concerts that a symphony orchestra can adequately rehearse and present in the course of a concert season. This situation has, therefore, resulted in greatly increased operating deficits. A study of the operating deficits of the orchestras for the concert season of 1944-45, in comparison with season 1950-51, discloses the alarming fact that operating deficits show an increase of more than 85 percent. Under the pressure of these conditions the Detroit Symphony and the Columbus Philharmonic were forced to abandon their activities. There is grave danger that further casualties may be expected unless these trends can be changed. The loss to the musical world through the abandonment of any fine symphony orchestra is incalculable.

The difficult problem of symphony-orchestra finance must and will be dealt with by the boards of directors of our supporting associations. We have never had, nor do we now request, governmental subsidy such as is almost universally accorded such projects in other countries. There is a way, however, in which our Government can remove a burden from our shoulders, the release of which will be of infinite help in working out a solution of our problems.

Under the present regulations 20 percent of every dollar collected from the public from the sale of tickets for symphony concerts must be paid over to the Government as an excise tax. We are convinced that this excise tax is a great deterrent to symphony concert attendance. We also know that we have little chance of adjusting our admission prices to conform to greatly increased operating costs as long as this 20 percent excise tax on our admissions remains in effect.

During World War I the Government first levied a war tax on admissions of all kinds. At the conclusion of that war the Internal Revenue Code was amended to read: "No tax shall be levied in respect of societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions * * * and no part of the net earnings thereof inures to the benefit of any private stockholder or individual." This specific exemption remained in effect until the beginning of World War II; then in 1941 this exemption was repealed and a tax of 10 percent was imposed. In 1943 this tax was increased to 20 percent as a wartime revenue measure and with the assurance openly given by Government officials that it "shall continue only until approximately 6 months after the termination of the war."

We appeal to this honorable committee and to the Congress to restore the same exemption that the symphony orchestra associations and societies enjoyed during the period from 1919 to 1941. We believe the Congress should follow the precedent established at the end of World War I, and we further believe this procedure is justified for the following reasons:

WHY THIS TAX BURDEN SHOULD BE LIFTED

1. Taxation of the receipts of a symphony orchestra association is inconsistent with the Government's entire attitude toward the institution with respect to all other taxes. Symphony associations are not subject to income or other taxes, and the same philosophy which makes them exempt from such taxation justifies their exemption from the admissions tax.

2. There is further inconsistency in the Government's tax position. On the one hand, the Government permits contributors to deduct from income and other taxes their contributions to symphonic institutions. On the other hand, the Government still is imposing an indirect tax—on admissions—on the operation of the same institution.

3. In practically all other countries, symphony associations not only enjoy tax exemption but they are almost wholly supported by governmental funds. Our symphony associations are not appealing to the Government for a subsidy. Symphony organizations are hard pressed to meet the annually recurring deficits through solicitations from the public. The public should not be subjected to the additional burden of tax on admissions.

4. The problem of symphony deficits is not limited to a small number of cities nor to the small number of people in the upper-income brackets. At least 500

communities of varying size recognize the same acute dilemma in their symphony societies, and the audiences which attend their concerts represent a complete cross section, at every income level, of those who enjoy and appreciate the inspiration of symphonic music. Relief from the burden of the admissions tax would be of relatively greater value to the smaller orchestral associations throughout the country, whose maintenance is in delicate balance from year to year because of financial deficits in communities of middle-class incomes.

5. The directors of these musical institutions have not sat back lazily and waited for relief from the Government repeal of the admissions tax. Every effort already has been made to tap sources of additional income—radio broadcasts, phonograph-record royalties, and other activities. Still the deficits are increasing because symphony payrolls have increased on the same pattern as all other operating costs in industry.

6. The total amount of the annual tax on symphony admissions, while large in terms of orchestra financing, is negligible in terms of the national budget. The total admissions tax collected from the country's leading 25 orchestras in the year 1947–48 amounted to slightly more than $1,000,000. For the same period, the total operating deficits for those 25 orchestras was more than 3½ million dollars. These figures represent a year of great prosperity when ticket sales reached a high level.

CONCLUSION

Symphony orchestras are the fount and mainspring of all musical life and acitivity in America. This Nation has taken world-leadership in this form of the musical art, and no other nation has so many nor such fine symphony orchestras. Millions of Americans across the Nation enjoy the concerts given by our more than 500 symphony orchestras in communities of every size. The symphony concerts given exclusively for children at nominal cost, or often without charge, form an integral part of the musical program of our schools. Symphony-orchestra members are the source for teaching staffs of our schools and colleges.

Therefore, the restoration of the exemption from admission taxes, as it existed during the years 1919 to 1941, is urged upon Congress as a step to be taken to make possible the continuance of the invaluable cultural and educational benefits flowing from the maintenance of symphony orchestras in the United States, and to insure the continued employment of thousands of the world's finest musicians.

We respectfully request that the foregoing statement be made a part of the record of the public hearings on H. R. 4473, now under consideration by the Finance Committee of the United States Senate, Eighty-second Congress, first session.

STATEMENT OF MRS. HELEN M. THOMPSON, EXECUTIVE SECRETARY-TREASURER OF THE AMERICAN SYMPHONY ORCHESTRA LEAGUE, INC.

Mr. Chairman and members of the committee, I am grateful for the opportunity of appearing before you today on behalf of the American Symphony Orchestra League, a nonprofit service organization composed of the community or so-called amateur symphony orchestras throughout the Nation.

Before presenting my statement on behalf of this group, however, I desire to offer for the record the statement of Mr. Arthur J. Gaines, manager of the Minneapolis Symphony Orchestra and chairman of a committee of larger symphonies who have long advocated the repeal of the admissions tax. The statement by Mr. Gaines is presented for the record, and the waiving of his verbal testimony is a desire on our part to cooperate with your committee in speeding these hearings to a conclusion.

Mr. Gaines is not present today, but with me at the witness table is Mr. John Edwards, manager of the National Symphony Orchestra here in Washington, who will be glad to answer any questions which members of the committee might desire to propound concerning the work of the larger orchestras, at the conclusion of my testimony.

The statement of Mr. Gaines adequately describes the effect of the 20 percent excise tax on some 30 of the Nation's symphonies whose names all of you know. I want to tell you a bit about the effect of that tax on our orchestras.

The names of most of the 600 orchestras which I represent are neither famous nor are they often known beyond their own communities or States, but they are vitally important, and for a very simple reason. They provide opportunities for our American people actually to make great music—to develop their community's cultural life.

True culture is a living, vital process. It is not produced by purchasing a few concerts a year on a one-night-stand basis. Culture means weaving music and the other arts into the warp and woof of daily living. It is a way of life. And when you have adults, college and high-school students drawn from all social and economic strata of a community voluntarily meeting together week after week to learn great music; when you have the elevator boy and the town banker sitting side by side playing the same notes from a sheet of music; when you have the women of a community, the business and professional interests, skilled and unskilled workers, industry's leaders and the labor unions joining together in working and contributing toward the support of that music; when you have thousands of men, women, and children regularly attending concerts played by their fellow townspeople, then you have culture putting down strong roots in a community.

That, gentlemen, is exactly what is happening in the 600 American cities and towns where our nonprofessional and so-called amateur orchestras are established. In those communities, Beethoven becomes a recognized competitor of bebop. Boogie-woogie and the juke boxes begin to lose out to the sonata form, the rehearsal and concert halls. Yet, these very same community ventures in better living, music education, and culture are subjected to the crippling Federal excise tax.

When compared to the professional symphonies, our community symphony financial operations are modest. Our orchestras exist solely because men and women contribute their time and talents as musicians, conductors, administrators, and fund raisers. They do it so that there will be live music of the finest order in their own communities for themselves and their children.

But, regardless of all this contributed help, our orchestras must pay for certain goods and services, including music, rehearsal and concert-hall rentals, stage hands, trucking services, printing, etc. All of that money must be obtained from sale of tickets and contributions. Our orchestras can't help finance themselves through broadcasts, recordings, television contracts, and tours because they aren't professional groups. After careful study and analysis of our orchestras' operations, we know that a modestly organized community orchestra can reasonably expect to raise a gross income of about 25 cents per capita for the corporate population of its city.

Also, we find there is a very definite limit to the total price which can be charged for symphony tickets in these small cities, regardless of how that price is broken down as to admission costs and taxes. It's the total amount which the purchaser has to reckon with. If the Federal Government gets 20 percent of the total, it simply means that the orchestra has that much less money to work with. Additional increases to cover rising costs and taxes cannot be passed on to your patrons as is the prevailing habit in business. Such costs have to be absorbed by the organization. More often than not, the orchestras' gross incomes fall short of meeting minimum operation costs. Deficits occur, then pile up, and the orchestra, having no borrowing power nor capital assets, is forced to find a check-writing "angel" at the end of the season, or disband. And check-writing "angels" have almost ceased to exist. I can cite orchestra after orchestra throughout the Nation where, over a period of several years, the operating deficits are just about equivalent to the Federal excise-tax bills which they pay.

For instance, during the 1950–51 season, my own orchestra in Charleston, W. Va., operated on a total of $30,000, for it pays its conductor and some of its musicians. The deficit is $1,675. The year's excise-tax bill is $1,600.

In Grand Rapids, Mich., the orchestra pays an annual tax bill of $2,500; suffers operating deficits of between $2,000 and $3,000 each year. The orchestra's women's auxiliary has been putting on all kinds of benefits to try and make up the difference. Recently that orchestra stated that the Federal admissions tax will probably be the deciding factor between continuance or disbandment of that community orchestra.

Eugene Reichenfeld, conductor of the Wilkinsburg, Pa., orchestra, recently called me to discuss their difficulties. "Here in Wilkinsburg," he said, "we have all worked and slaved for our orchestra for years, because we love it and because our community so desperately needs it, but we cannot surmount this tax problem much longer. This year we raised only $4,000, and for the third year in succession we paid $1,200 in excise tax. Also for the third year in succession our deficit was $1,200. Financially, we just keep falling farther and farther back, and our people are becoming so disheartened and discouraged over what appears to be a hopeless situation that if we don't get some relief we are going to give up our orchestra. And Mrs. Thompson," he added, "you know that we aren't hiring in musicians from all over the place. We take our own Wilkinsburg boys and girls and adults and teach them to become symphony musicians. What will happen to their music if we disband? Surely, if our Government understood what we are doing and knew our problems, it would feel that our $1,200 would be better spent right here in Wilkinsburg, making our city a better place in which to live, providing a finer community in which to raise our children."

Mr. Reichenfeld's story is repeated all around the Nation.

In Bangor, Maine, in 1896, 10 musicians gathered together to play fine music on a volunteer basis. Their work has been continued and expanded until now, in 1951, 70 musicians gather together to present several full-scale symphony concerts each season in Bangor, a city of 30,000 population.

That orchestra has developed Bangor's musical talent all these years and today many of its former orchestra members are helping develop music in other Maine communities. In addition to the Bangor orchestra's concert and music education work, it operates a music center as a community service; provides space and facilities for the Bangor community chorus, the city band, the musicians' association, music clubs, and for the music branch of the Bangor Public Library.

Not a single one of the Bangor symphony musicians has ever received any remuneration for playing in the orchestra during its 55 years of operation. This last season, the orchestra's total cash income was about $1,500 and it paid out $450 in Federal excise taxes—a tax, gentlemen, not on a profit-making entertainment venture, but on a community, educational undertaking carried on through volunteer efforts and contributions of Bangor's citizens.

In Winston-Salem, N. C., there is a 5-year-old orchestra. That orchestra pays its conductor, a young college professor, about $1,000 or $1,500 a year and pays the musicians a dollar or two for each rehearsal in order to cover their transportation expenses.

The orchestra is very concerned about its obligation to make fine music available to the colored people in Winston-Salem and is trying to figure out ways and means of financing it. The orchestra faces difficulty in doing so because of the Federal excise tax. It operates on only about $8,000 a year and, not being able to meet a tax bill, constituted itself as a membership society whereby all members are entitled to attend all concerts and other orchestra social and business functions. It can't sell any tickets under this set-up and so is placed in a very difficult position in trying to carry on a fine civic project which would offer distinct advantages to all the citizens of Winston-Salem while at the same time meeting the requirements of its Federal Government.

So, in this case, we find the Federal Government, through its present excise-tax provisions relating to nonprofit symphony orchestras, is presenting an obstacle to civic advancement—all for a cash consideration to the Government of about $1,000 a year. Gentlemen, I ask you, wouldn't the results of increased good will between our two great American races in a fine southern city be worth a great deal more to national unity than is a matter of $1,000 cash in excise-tax collections?

In Williamsport, Pa., a city of about 45,000 population, there is a symphony orchestra. Its musicians are the townspeople and students. Its president is one of the city's leading druggists. The orchestra conductor is the high-school music director.

Practically none of the Williamsport musicians receives any money for playing or rehearsing. That orchestra spends what money it has on music education. Outstanding young student musicians are offered cash scholarships to enable them to attend the Nation's finest conservatories and so enhance our national cultural resources. Six scholarships were awarded this year.

In order to finance these scholarships, Williamsport citizens contribute money to the Williamsport Symphony and buy tickets to its concerts. The symphony must pay 20 percent of the gross ticket income to the Federal Government. Each year that tax payment would enable two or three more young people to develop a talent which is theirs only through heritage. Instead, those two or three young people are denied that opportunity and this country may be denied a great musician, all because of the payment of a few hundred dollars in excise taxes levied on a nonprofit, cultural, and educational community project.

Delaware, being on the eastern seaboard and close to several of the Nation's great cultural centers, has many finely trained professional musicians, as well as the advanced amateur or nonprofessional musicians. For several years there has been a community orchestra in Wilmington.

In order to extend the cultural opportunities in the State and provide seriously needed employment for the professional musicians, the Delaware Philharmonic Orchestra was formed a couple of years ago, but the burden of financial problems, plus the 20-percent excise tax, has proven almost too much for it and its program is falling far short of the wonderful goals it set out to reach.

Nebraska believes in fine music too. That State, with only 9 cities having populations of 10,000 or more, has at least 4 symphony orchestras. They all operate on a community basis, with musicians and citizens volunteering all or part of the time and talent needed by the orchestras, but they are all having a bitter struggle financially. Again, in Nebraska, we find the orchestra deficits paralleling their excise-tax bill. They just can't seem to raise that additional amount of money needed in order to pay both the Government taxes and operating costs. Eventually something will have to give or the orchestras will cease operations. The Hastings (Nebr.) Symphony feels so strongly the need for tax relief that it recently sent one of the board members here to Washington to discuss the matter with Congressmen from Nebraska and neighboring states.

Colorado and Oklahoma each have their own orchestras, both professional and nonprofessional. In Colorado there are the Denver Symphony, the Denver Businessmen's Symphony, the Colorado Springs, Fort Collins, Greeley, Pueblo, and the college and university orchestras. Also, there is the Arkansas Valley Symphony at La Junta, 8,000 population. This orchestra was formed 2 years ago when a college music instructor first came to the community and discovered that most of the people in the community had never had a chance to attend a symphony concert, much less play in a symphony orchestra.

In order to exist at all, this orchestra draws its players from 10 different small communities in the valley. Many of the musicians drive as far as 50 miles one way in order to attend rehearsals and concerts, and a large percentage of them are high-school boys and girls. None of the musicians nor the conductor receives any remuneration from the orchestra, but still the Government requires that orchestra to pay a 20-percent Federal excise tax on its tickets just the same as if it were a dazzling circus operated for personal profit.

Oklahoma has at least five symphonies and its Oklahoma City Symphony, a very modestly financed professional orchestra, performed one of the Nation's outstanding cultural services last year when it played an entire series of sustaining radio broadcasts beamed to the iron curtain. These concerts high lighted contemporary music of the countries of the world. In these concerts, men spoke to each other the world over through music—the language of the heart—and understanding between diverse peoples was enhanced.

Yet, this orchestra, supported by Oklahoma City citizens, must constantly reckon with the provisions of the 20 percent Federal excise-tax statutes which now include levies on nonprofit, educational, and cultural organizations. In desperation, it constituted itself as a closed membership society.

Georgia boasts of at least three or four symphony orchestras. Ohio, Texas, and Virginia has theirs—both professional and community orchestras. Within these states are to be found symphonies whose names you well know: the Atlanta, Cincinnati, Cleveland, Houston, Dallas, and San Antonio Symphonies. Also you will find the less well known orchestras, such as the Lima Ohio Little Symphony, the Doctor's Orchestra in Akron, the Columbiana County Symphony in Lisbon, Ohio, the Waco, Lubbock, and Wichita Falls Symphonies in Texas, the Richmond and Norfolk orchestras in Virginia.

All are carrying on projects which increase the cultural resources of these cities. They play music written by their own local composers. They present soloists drawn from their own areas. They sponsor youth symphonies. They play children's concerts. They play for the Christmas Messiah performances given each year by church and community choirs. They provide an opportunity for the formal music education offered in public schools and colleges to be translated into community assets as adults continue playing music after their school years are over. These orchestras discover, encourage and nurture creative talents to be found among our own American people. They are maintained through the faith, vision, hard work, and personal sacrifices of the people in their communities and all of these orchestras are burdened down by impossible excise-tax bills which the citizens consider grossly unjust. Each year the financial struggle is greater. Each year a little more of the joy, spontaniety, and creative spirit of these community efforts are crushed out of them because of the tax structure.

Yet these same orchestras are the only medium through which Cross Roads Americans can participate in developing a truly American treasury of symphonic music; the only medium through which American composers, American solo artists, American instrumentalities, and American conductors can learn their craft and develop their art. Just as America's skilled trade guilds provide apprentice training, so do our community orchestras provide training centers for America's world of music and culture.

Gentlemen, because of these things, we earnestly beseech you not to weigh down these orchestras with a continuation of the excise-tax levy. Instead, we respectfully ask you to free our orchestras from this burden. By so doing you will in effect be saying, "Yes, America must have food for its heart and soul—especially in these trying times, and the Congress of the United States notes with pride that her people are providing that cultural life for themselves with no request for governmental subsidies. In recognition of their work, in recognition of the national need to nourish creative talent, the United States Government frees America's nonprofit symphony orchestras from a prostrating tax burden conceived during a former war economy and established as a temporary measure."

And now, gentlemen of the Senate Finance Committee, and to file with you a list of America's 670 symphony orchestras, and in the name of these orchestras, to thank you for this opportunity to tell you of our problems and needs. We hereby trustfully place them in your hands.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951

[NOTE.—This list is known to be incomplete inasmuch as new orchestras constantly are being established The list does not include high school orchestras.]

State	City	Orchestra
Alabama	Auburn	Alabama Polytechnic Institute Symphony.
	Birmingham	Birmingham Civic Symphony.
	Jacksonville	Jacksonville State College Orchestra.
	Mobile	Mobile Chamber Orchestra.
	Montevallo	Alabama College Orchestra.
	Montgomery	Montgomery Civic Symphony.
	Tuscaloosa	University of Alabama Symphony.
Arizona	Phoenix	Phoenix Symphony.
	Tucson	Tucson Symphony Orchestra.
Arkansas	Conway	Hendrix Symphony.
	Fayetteville	University Orchestra.
	Fort Smith	Fort Smith Symphony Orchestra.
	Little Rock	Arkansas State Symphony Association.
California	Angwin	Pacific Union College Concert Orchestra.
	Arcata	Humboldt Little Symphony.
	Arlington	La Sierra College Concert Orchestra.
	Bakersfield	Kern Philharmonic Society.
	Berkeley	Armstrong College Symphony.
	do	(The) Musicians' Union Orchestra.
	do	University of California Symphony Orchestra.
	Burbank	Burbank Symphony Association.
	Chico	Chico State College—Community Little Symphony.
	Claremont	Orchestra of Pomona College.
	Davis	California Aggie Orchestra.
	Fresno	Fresno State College Symphony Orchestra.
	Glendale	Glendale Symphony Orchestra.
	Huntington Park	Huntington Park Symphony Orchestra.
	Inglewood	Inglewood Symphony Orchestra.
	Long Beach	Little Symphony Orchestra of Long Beach.
	do	Long Beach Philharmonic Symphony.
	do	Woman's Symphony Orchestra.
	Los Angeles	Los Angeles Junior Philharmonic.
	do	Los Angeles Philharmonic Orchestra.
	do	Los Angeles String Orchestra.
	do	Los Angeles Women's Symphony.
	do	Meremblum Junior Symphony Orchestra.
	do	Occidental College Orchestra.
	do	Pepperdine Community Orchestra.
	do	University of California at Los Angeles Symphony Orchestra.
	do	University of Southern California Orchestra.
	Monrovia	San Gabriel Valley Symphony.
	Oakland	Holy Names College Orchestra.
	do	Mills College Ensemble.
	do	Oakland Symphony Orchestra.
	Pasadena	California Technical Orchestra.
	do	Pasadena Civil Music Association.
	Redlands	University Orchestra.
	Sacramento	Sacramento Philharmonic Association.
	do	Sacramento State College Little Symphony.
	Salinas	Monterey County Symphony Orchestra.
	San Bernardino	San Bernardino Valley Symphony.
	San Carlos	Sequoia Symphony Association.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
California	San Diego	San Diego Community Symphony Orchestra.
	do	San Diego Philharmonic Orchestra.
	do	San Diego State College Orchestra.
	San Francisco	San Francisco Rehearsal Orchestra.
	do	San Francisco State College Symphony.
	do	San Francisco Symphony Orchestra.
	San Jose	San Jose Civic Symphony Association.
	do	San Jose State College Orchestra.
	Santa Barbara	Santa Barbara Orchestra.
	do	Westmont College Orchestra.
	Santa Monica	Santa Monica Civic Orchestra.
	Santa Rosa	Sonoma County Symphony Orchestra.
	Stockton	College of the Pacific Conservatory Orchestra.
	do	Stockton Symphony Orchestra.
	Vallejo	Vallejo Symphony Orchestra.
	Whittier	Whittier College-Community Symphony Orchestra.
Colorado	Boulder	University of Colorado Symphony Orchestra.
	Colorado Springs	Colorado Springs Symphony Orchestra Association.
	Denver	Denver Businessmen's Orchestra.
	do	Denver Civic Symphony Orchestra.
	do	Denver Symphony Orchestra.
	Fort Collins	Colorado Arts and Mechanics College Orchestra.
	do	Fort Collins Civic Symphony.
	Greeley	Greeley Philharmonic Orchestra.
	La Junta	Arkansas Valley Symphony Orchestra.
	Pueblo	Pueblo Civic Symphony Orchestra.
Connecticut	Bridgeport	Connecticut Symphony Orchestra.
	do	University of Bridgeport Community Orchestra.
	Hartford	The Symphony Society of Greater Hartford.
	New Haven	Business and Professional Men's Orchestra.
	do	Johnson Junior Symphony.
	do	New Haven Symphony Orchestra.
	do	Yale Music School Ensemble.
	New London	New London Symphony Orchestra.
	Norwalk	Norwalk Symphony.
	Thompsonville	Enfield Symphony Orchestra.
	Torrington	Torrington Symphony Orchestra.
	Waterbury	Waterbury Civic Orchestra.
	Willimantic	Willimantic Symphony Orchestra.
	Woodbury	Woodbury Symphony Orchestra.
Delaware	Wilmington	Delaware Philharmonic Symphony.
	do	Wilmington Symphony Orchestra.
Florida	Coral Gables	University of Miami Symphony.
	Daytona Beach	Bethune Cookman College Orchestra.
	do	Daytona Beach Youth Symphony Orchestra.
	Deland	Stetson Symphony Orchestra.
	Fort Lauderdale	Fort Lauderdale Symphony Orchestra.
	Gainesville	University of Florida Symphony Orchestra.
	Jacksonville	Jacksonville Philharmonic Orchestra.
	Lakeland	Florida Southern College Orchestra.
	Miami	University of Miami Symphony Orchestra.
	Orlando	Orlando Civic Orchestra.
	Sarasota	Florida West Coast Symphony.
	Tallahassee	Florida State Symphony.
	do	Florida State University Symphony.
	Tampa	Tampa Symphony Orchestra.
Georgia	Atlanta	Atlanta Symphony Orchestra.
	do	Atlanta-Spelman-Morehouse Orchestra.
	Demorest	Piedmont Orchestra.
	Gainesville	Brenau College Orchestra.
	Macon	Macon Symphony Orchestra.
	Savannah	Savannah Little Symphony.
	do	Savannah Music Association Orchestra.
Idaho	Boise	Boise Symphony Orchestra.
	do	Boise College-Civic Orchestra.
	Idaho Falls	Idaho Falls Symphony Orchestra.
	Moscow	University of Idaho Symphony Orchestra.
	Pocatello	Idaho State Symphony.
	Rexburg	Rexburg Symphony Orchestra.
Illinois	Alton	Madison County Symphony Orchestra.
	Aurora	Aurora Civic Orchestra.
	Bloomington	Bloomington-Normal Symphony.
	do	Illinois Wesleyan University Symphony.
	Carbondale	Southern Illinois Symphony.
	Carthage	Carthage College-Community Symphony Orchestra.
	Charleston	Eastern Illinois State College Orchestra.
	Decatur	Millikin Civic Orchestra.
	Elsah	The Principia College Orchestra.
	Evanston	Evanston Civic Orchestra Association.
	do	Northwestern University Symphony Orchestra.
	Galesburg	Knox College Sinfonietta.
	Jacksonville	MacMurray College String Ensemble.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
Illinois	Joliet	Joliet Junior College Little Symphony.
	do	Joliet Symphony Orchestra.
	Kankakee	Kankakee-Olivet Symphony.
	Kewanee	Kewanee Civic Orchestra.
	La Grange	West Suburban Symphony Orchestra.
	Monmouth	Monmouth College Orchestra.
	Oak Park	Oak Park-River Forest Orchestra.
	Peoria	Peoria Symphony Orchestra.
	Quincy	Quincy Little Symphony.
	Rock Island	Augustana College Orchestra.
	Rockford	Rockford Civic Symphony Association.
	Springfield	Springfield Symphony Orchestry.
	Urbana	University of Illinois Symphony Orchestra.
	Vienna	Vienna Symphony Orchestra.
	Waukegan	Waukegan Philharmonic Orchestra.
	Wheaton	Wheaton College Symphony.
	Zion	Zion Symphony Orchestra.
	Chicago	Chicago Business Men's Orchestra.
		Chicago Symphony Orchestra.
		DePaul University Symphony.
		Elgar's Orchestra.
		Midwestern Conservatory of Music Orchestra.
		North Side Symphony Orchestra.
		University of Chicago Symphony Orchestra.
Indiana	Bloomington	Indiana University Symphony.
	Columbus	Columbus Symphony Orchestra.
	Crawfordsville	Crawfordsville Symphony.
	Danville	The Hoosier Symphony Orchestra and Chorale.
	do	Canterbury Symphonette.
	Elkhart	Elkhart Symphony Orchestra.
	Evansville	Evansville Philharmonic Orchestra.
	Fort Wayne	Fort Wayne Philharmonic Orchestra.
	Gary	Gary Symphony Society, Inc.
	Greencastle	DePauw University Symphony Orchestra.
	Indianapolis	Arthur Jordan Conservatory Orchestra.
	do	Indianapolis Symphony Orchestra.
	Lafayette	Lafayette Symphony Orchestra.
	do	Purdue University Orchestra.
	Marion	Marion College Orchestra.
	Muncie	Muncie Community Symphony Orchestra.
	North Manchester	North Manchester Civic Symphony Orchestra.
	do	North Manchester String Symphony.
	Notre Dame	Notre Dame Symphonette.
	St. Mary-of-the-Woods.	St. Mary-of-the-Woods College Sinfonietta.
	South Bend	South Bend Symphony Orchestra.
	Terre Haute	Terre Haute Civic and Teachers College Symphony Orchestra.
	Valparaiso	Valparaiso University Orchestra.
Iowa	Ames	Iowa State Symphony Orchestra.
	Burlington	Junior College Little Symphony.
	Cedar Rapids	Cedar Rapids Symphony Orchestra.
	do	Coe College Orchestra.
	Davenport	Ambrose Concert Orchestra.
	do	Tri-City Symphony Orchestra Association.
	Decorah	Luther College Concert Band.
	Des Moines	Drake-Des Moines Symphony Orchestra.
	Dubuque	University of Dubuque Orchestra.
	Grinnell	Grinnell College Orchestra.
	Iowa City	The University Symphony Orchestra.
	Lamoni	Graceland-Lamoni Orchestra.
	Mason City	Mason City Woman's Symphony Orchestra.
	Mount Vernon	Cornell College Symphony Orchestra.
	Pella	The Central College Orchestra.
	Sioux City	Briar Cliff College Orchestra.
	do	Sioux City Symphony Orchestra.
	Waterloo	Waterloo Symphony.
Kansas	Hays	Fort Hays Symphony.
	Independence	Southeast Kansas Symphony Orchastra.
	Lindsborg	Bethany Symphony Orchestra.
	Manhattan	College-Civic Orchestra.
	Ottawa	University-Civic Symphony.
	Topeka	Topeka Civic Orchestra.
	Wichita	Friends University Orchestra.
	do	The Wichita Symphony Orchestra.
	Winfield	Southwestern College Symphony Orchestra.
	do	Winfield Civic Orchestra.
	Xavier	St. Mary College Orchestra.
Kentucky	Ashland	Ashland Junior College Civic Orchestra.
	Berea	Berea College Orchestra.
	Lexington	Transylvania College Orchestra.
	do	University of Kentucky Symphony Orchestra.
	Louisville	Louisville Philharmonic Orchestra.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
Louisiana	Baton Rouge	Baton Rouge Civic Symphony.
	Hammond	Southeastern Louisiana College Orchestra.
	Lafayette	Southwestern Symphony Orchestra.
	Natchitoches	Northwestern State College Symphony Orchestra.
	New Orleans	New Orleans Symphony Society.
	....do	The Summer "Pop" Concerts, Inc.
	Pineville	Alexandria-Pineville Symphony Orchestra.
	Ruston	Louisiana Tech. Symphony Orchestra.
	Shreveport	Shreveport Symphony Society.
Maine	Augusta	Korda Junior Symphony Orchestra.
	Bangor	Bangor Symphony Orchestra.
	Lewiston	Orphic Society Orchestra.
	Orono	University of Maine Symphony Orchestra.
	Portland	Portland Symphony Orchestra.
	Waterville	Colby-Community Symphony Orchestra.
Maryland	Baltimore	Baltimore Symphony Orchestra.
	....do	The Morgan College-Community Orchestra.
	Cumberland	Cumberland Civic Symphony.
	Frederick	Hood College Orchestra.
	Westminster	Western Maryland College Little Symphony Orchestra.
Massachusetts	Amherst	University Symphony Orchestra.
	Arlington	Arlington Philharmonic Society.
	Boston	Boston Civic Symphony Orchestra.
	....do	Boston Pops Orchestra.
	....do	Boston Symphony Orchestra.
	....do	Boston University Orchestra.
	....do	First Veterans Symphony Orchestra.
	....do	New England Conservatory Orchestra.
	Brockton	Brockton Orchestral Society.
	....do	Whitman Orchestral Club Orchestra.
	Cambridge	Harvard University Orchestra.
	Fall River	Fall River Symphony Orchestra.
	Framingham	Framingham Civic League Orchestra.
	Haverhill	Haverhill Civic Symphony Orchestra.
	Hingham	Hingham Civic Orchestra.
	Lawrence	Lawrence High School Alumni Symphony Orchestra.
	Lowell	Lowell Philharmonic Orchestra.
	Lynn	North Shore Philharmonic.
	Malden	Weltman Orchestral Society.
	Medford	Tufts Community Orchestra.
	New Bedford	New Bedford Chamber Music Society.
	....do	New Bedford Symphony Orchestra.
	North Adams	Berkshire Community Orchestra.
	....do	North Adams Symphony Orchestra.
	Northampton	Smith College Orchestra.
	Norton	Wheaton Community Orchestra.
	Norwood	Norwood Symphony Orchestra.
	Pittsfield	Pittsfield Community Symphony.
	Plymouth	Plymouth Philharmonic Symphony.
	Reading	Reading Symphony Orchestra.
	Salem	Salem Orchestra.
	Springfield	Springfield Symphony.
	Wellesley	Wellesley College Orchestra.
	Westfield	Westfield Symphony.
	Worcester	Clark University Orchestra.
	....do	Worcester Philharmonic.
	....do	Worcester Youth Orchestra.
Michigan	Ann Arbor	University of Michigan Symphony Orchestra.
	....do	Ann Arbor Civic Orchestra.
	Battle Creek	Battle Creek Symphony Orchestra.
	Benton Harbor	Twin City Symphonic Society.
	Berrien Springs	Emmanuel Missionary College Orchestra.
	Dearborn	Dearborn Civic Orchestra.
	Detroit	Scandinavian Symphony.
	....do	University of Michigan Extension Orchestra.
	....do	Wayne University Symphony Orchestra.
	East Lansing	Michigan State College Symphony Orchestra.
	Flint	Flint Symphony Orchestra.
	Grand Haven	West Shore Symphony.
	Grand Rapids	Grand Rapids Symphony Orchestra.
	Hamtramck	Hamtramck Philharmonic Orchestra.
	Hillsdale	Hillsdale College Symphony Orchestra.
	Holland	Hope College Orchestra.
	Jackson	Jackson Concert Orchestra.
	Kalamazoo	American Male Chorus Concert Association.
	....do	Kalamazoo Symphony Society.
	Lansing	Lansing Civic Symphony Orchestra.
	Marquette	Tri-City Symphony Orchestra.
	Midland	Dow Symphony Orchestra.
	Mount Clemens	Mount Clemens High School Symphony Orchestra.
	Muskegon	West Shore Symphony.
	Plymouth	Plymouth Symphony.
	Saginaw	Saginaw Civic Symphony.
	Ypsilanti	Ypsilanti Normal College Symphony.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
Minnesota	Collegeville	St. John's University Symphony Orchestra.
	Duluth	Duluth Symphony Orchestra.
	Hibbing	Range Symphony Orchestra.
	Minneapolis	Minneapolis Symphony Orchestra.
	.....do	Northwest Sinfonietta.
	.....do	University of Minnesota Symphony Orchestra.
	New Ulm	New Ulm Civic Orchestra.
	Northfield	The Carleton Orchestra.
	.....do	St. Olaf College Orchestra.
	Rochester	Rochester Symphony Orchestra.
	St. Cloud	St. Cloud Civic Orchestra.
	St. Paul	College Orchestra.
	.....do	Hamline University Orchestra.
	.....do	St. Paul Civic Orchestra.
	.....do	St. Thomas College Orchestra.
	St. Peter	Gustavus Adolphus Symphony Orchestra.
Mississippi	Blue Mountain	Blue Mountain College Orchestra.
	Jackson	Jackson Symphony Orchestra Association.
Missouri	Columbia	Burrall Symphony.
	Cape Girardeau	Cape Girardeau Symphony Orchestra.
	Conception	Conception Seminary Orchestra.
	Fayette	Central College Orchestra.
	Independence	Independence Symphony Orchestra.
	Jefferson City	Lincoln University Little Symphony.
	Kansas City	Kansas City Philharmonic.
	.....do	The University of Kansas City Symphony Orchestra.
	Parkville	Park College Orchestra.
	St. Charles	Lindenwood College Orchestra.
	St. Louis	St. Louis Philharmonic Society.
	.....do	St. Louis Symphony Orchestra.
	Sedalia	Sedalia Symphony Society.
	Springfield	Springfield Civic Symphony.
Montana	Billings	Billings Symphony Orchestra.
	.....do	Midland Symphony Orchestra.
	Bozeman	Montana State College Symphony.
	Glendive	Glendive Symphony Orchestra.
	Great Falls	Great Falls Symphony Orchestra.
	Missoula	Missoula Symphony Orchestra.
	.....do	Montana State University Symphony Orchestra.
	.....do	Rocky Mountain Symphony Orchestra.
Nebraska	Hastings	Hastings Civic Symphony.
	Kearney	Kearney Civic Symphony Orchestra.
	Lincoln	Lincoln Symphony Orchestra.
	do	University Symphony Orchestra.
	Omaha	Omaha Symphony Orchestra.
Nevada	Reno	Reno Civic Orchestra.
New Hampshire	Berlin	Berlin Symphony Orchestra.
	Concord	New Hampshire Symphony.
	Durham	University Symphony Orchestra.
	Hanover	Handel Society Symphony Orchestra of Dartmouth College.
New Jersey	Asbury Park	Spring Lake Sinfonietta.
	Atlantic City	Atlantic City Symphony Orchestra.
	.....do	Center Symphony Orchestra.
	Bergen	Bergen Symphony Society.
	Bloomfield	Bloomfield Symphony Orchestra.
	Camden	New Jersey Philharmonic Symphony Orchestra.
	Carney's Point	YMCA Symphony Orchestra.
	Elizabeth	Elizabeth Philharmonic Society.
	Hudson County	West Hudson Symphony Orchestra.
	Jersey City	Jersey City Philharmonic Symphony Orchestra.
	Newark	Essex County Symphony Society.
	New Brunswick	New Brunswick Civic Symphony Orchestra.
	.....do	Rutgers Symphony Orchestra.
	Nutley	Mount Lakes Symphony Orchestra.
	.....do	Nutley Symphony Society.
	Orange	New Jersey Symphony.
	Paterson	Passaic-Bergen County Orchestra.
	Passaic	Passaic-Bergen Symphonic Society.
	Paterson	Paterson Philharmonic.
	Plainfield	Plainfield Symphony Society.
	Roselle	New Jersey Symphony.
	Trenton	Trenton Symphony.
New Mexico	Albuquerque	Albuquerque Civic Symphony.
	Portales	Eastern New Mexico University Symphonette Orchestra.
New York	Albany	Albany Symphony Orchestra.
	Babylon	Town of Babylon Symphony Association.
	Batavia	Batavia Civic Orchestra.
	Bronxville	Bronx Symphony Orchestra.
	Do	Sarah Lawrence Ensemble.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
New York	Brooklyn	Brooklyn College Symphony.
	Do	Brooklyn Little Symphony.
	Do	Brooklyn String Orchestra.
	Buffalo	Buffalo Philharmonic Orchestra.
	Corning	Corning and Painted Post Philharmonic Society.
	Elmira	Little Symphony.
	Flushing	Queens College Orchestra.
	Houghton	Houghton College Symphony Orchestra.
	Ithaca	Ithaca College Symphony Orchestra.
	Do	The University Orchestra.
	Jamestown	Jamestown Civic Orchestra, Inc.
	Little Falls	Little Falls Symphony Orchestra.
	Lockport	Lockport Symphony Orchestra.
	Mount Vernon	Mount Vernon Symphony Orchestra.
	New Rochelle	New Rochelle Symphony.
	Niagara Falls	Philharmonic Orchestra of Niagara Falls.
	Oneida	Kenwood-Sherrill Symphony Orchestra.
	Oneonta	Hartwick College Orchestra.
	Peekskill	Peekskill Civic Orchestra.
	Potsdam	Potsdam State Symphony Orchestra.
	Poughkeepsie	Dutchess County Philharmonic Society.
	do	The Vassar College Orchestra.
	Rochester	Eastman School of Music Junior Symphony Orchestra.
	do	Eastman School of Music Little Symphony.
	do	Eastman School of Music Senior Symphony Orchestra.
	do	Rochester Civic Orchestra.
	do	Rochester Philharmonic Orchestra.
	Saratoga Springs	Skidmore College Orchestra.
	Schenectady	Schenectady Symphony Orchestra.
	Staten Island	Staten Island Civic Symphony.
	do	Wagner College Symphonic Orchestra.
	Syracuse	Syracuse Civic Symphony.
	do	Syracuse String Quartet.
	do	Syracuse University Symphony.
	Tarrytown	Hudson Valley Symphony.
	Troy	R. P. I. Orchestra.
	Utica	Utica Civic Orchestra.
	do	Utica Symphonette.
	Watertown	Watertown Symphony Orchestra.
	White Plains	United Nations Symphony Orchestra.
	do	Westchester Symphony.
	Yonkers	Yonkers Philharmonic Orchestra.
	New York City	The City College Symphony Orchestra.
	do	Columbia University Chamber Orchestra.
	do	Hunter College Orchestra.
	do	Judge Prince's City Amateur Symphony Orchestra.
	do	Kraeuter Trio.
	do	Little Orchestra Society, Inc.
	do	Manhattan Symphonette.
	do	Metropolitan Bell Symphony Society.
	do	Mozart Orchestra of the Henry Street Settlement.
	do	National Orchestral Association.
	do	NBC Symphony Orchestra.
	do	New York City Symphony.
	do	New York Doctors' Symphony.
	do	New York Junior Symphony.
	do	New York Little Symphony.
	do	New York Philharmonic Society.
	do	Washington Heights "Y" Symphony Orchestra.
	do	Washington Square College Orchestra.
	do	Yeshiva University Orchestra.
North Carolina	Chapel Hill	North Carolina State Symphony.
	do	University Symphony Orchestra.
	Charlotte	Charlotte Symphony Orchestra.
	Davidson	Davidson Little Symphony.
	Durham	Duke University Symphony Orchestra.
	Guilford College	Civic and Teachers College Symphony Orchestra.
	Greensboro	Greensboro Orchestra.
	Raleigh	North Carolina State College Symphony Orchestra
	do	Raleigh Chamber Music Guild Sinfonietta.
	do	State College Little Symphony.
	Salisbury	Salisbury Civic Orchestra.
	Winston-Salem	Winston-Salem Symphony Association.
North Dakota	Bismarck	Bismarck Symphony Orchestra Association.
	Fargo	Fargo Moorhead Orchestra Association.
	Grand Forks	University Concert Orchestra.
Ohio	Akron	Doctors Orchestra.
	Alliance	Mount Union College Symphonic Orchestra.
	Ashland	Ashland Symphony Orchestra.
	Athens	Ohio University Symphony Orchestra.
	Berea	Baldwin-Wallace (College) Symphony.
	Bluffton	Bluffton College Orchestra.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
Ohio	Cambridge	Cambridge String Choir.
	Canton	Canton Symphony Orchestra.
	Cincinnati	Cincinnati Civic Orchestra.
	do	Cincinnati Community Symphony of the Jewish Center.
	do	Cincinnati Symphony Orchestra.
	Cleveland	Cleveland Heights Symphony Orchestra.
	do	Cleveland Orchestra.
	do	Western Reserve University Orchestra.
	Columbus	Capital University Symphony Orchestra.
	do	Ohio State University Symphony.
	Dayton	Dayton Philharmonic Orchestra Association.
	Delaware	Ohio Wesleyan University Symphony.
	Dover	Philharmonic Orchestra of Tuscarawas County.
	Lima	Lima Little Symphony.
	Lisbon	Columbiana County Symphony Orchestra.
	Lorain	Lorain Philharmonic Orchestra.
	Middletown	Middletown Civic Symphony Orchestra.
	New Concord	Muskingum College Orchestra.
	Newark	Licking County Philharmonic.
	Oberlin	Conservatory Orchestra.
	do	Conservatory Training Orchestra.
	Oxford	Miami University Symphony Orchestra.
	Painesville	Painesville Civic Orchestra.
	Shaker Heights	Shaker Heights Symphony Orchestra.
	Sidney	Sidney Music Club Orchestra.
	Springfield	Springfield Symphony.
	do	Wittenberg Symphonic Band.
	Toledo	Toledo Symphony Orchestra.
	Wilmington	Wilmington College Sinfonetta.
	Wooster	Wooster Symphony Orchestra.
	Youngstown	Youngstown College Symphony Orchestra.
	do	Youngstown Symphony Orchestra.
Oklahoma	Chickasha	Oklahoma College for Women Orchestra.
	Enid	Enid Symphony Orchestra.
	do	Phillips University Symphony.
	Norman	University Symphony Orchestra.
	Oklahoma City	Oklahoma City Symphony Orchestra.
	Stillwater	Oklahoma A. & M. College Orchestra.
	Tulsa	Tulsa Philharmonic Orchestra.
	do	University of Tulsa Symphony Orchestra.
Oregon	Corvallis	Oregon State College Orchestra.
	Eugene	Eugene Junior Symphony.
	do	University of Oregon Symphony.
	Forest Grove	Pacific University Orchestra.
	Hood River	Hood River Symphony Orchestra.
	La Grande	Eastern Oregon College Orchestra.
	Marylhurst	Marylhurst College Orchestra.
	Medford	Southern Oregon Philharmonic Society.
	McMinnville	Linfield Chamber Orchestra.
	Portland	Lewis and Clark College Symphony.
	do	Portland Junior Symphony Orchestra.
	do	Portland Symphony Orchestra.
	do	Sirpo Chamber Orchestra.
	do	University of Portland Orchestra.
	Salem	Willamette University Symphony Orchestra.
Pennsylvania	Allentown	Allentown Symphony Association.
	do	Lehigh Valley Symphony.
	Altoona	Altoona Civic Symphony Orchestra.
	Ambridge	Ambridge Community Symphony Orchestra.
	Beaver Falls	Geneva College Concert Orchestra.
	Butler	Butler County Orchestral Association.
	Chambersburg	Collegium Musicum Orchestra of Wilson College.
	Chester	Barclay Ensemble.
	Columbia	Columbia Symphony Orchestra Association.
	Easton	Lafayette College Little Symphony.
	do	Lafayette College String Ensemble.
	Erie	Erie Philharmonic Society.
	Greensburg	Seton Hill College Orchestra.
	Greenville	Greenville Symphony Orchestra.
	Harrisburg	Harrisburg Symphony Orchestra.
	Haverford	Haverford-Bryn Mawr College Orchestra.
	Honesdale	Honesdale Symphony Orchestra.
	Huntington	Juniata College Symphony Orchestra.
	Jenkintown	Old York Road Symphony Society.
	Johnstown	Johnstown Symphony Orchestra.
	Kennett Square	Kennett Community Symphony Orchestra.
	Lancaster	Franklin and Marshall Chamber Orchestra.
	do	Lancaster Community Symphony.
	Lewisburg	Bucknell University Symphony Orchestra.
	Mansfield	Mansfield Community Symphony Orchestra.
	Meadville	Meadville Orchestral Society.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States, Aug. 1, 1951—Continued

State	City	Orchestra
Pennsylvania	New Kensington	New Kensington Symphony Orchestra.
	Philadelphia	Drexel Institute Symphony Orchestra.
	do	Germantown Symphony Orchestra.
	do	Main Line Symphony.
	do	Philadelphia Orchestra.
	do	Philadelphia "Pops" Orchestra.
	do	Roxborough Symphony Orchestra.
	do	West Oak Lane Symphony Orchestra.
	Pittsburgh	Carnegie Music Department Symphony Orchestra.
	do	Chamber Orchestra of Pittsburgh.
	do	Duquesne University Symphony Orchestra.
	do	Pittsburgh Symphony Orchestra.
	Pottstown	Pottstown Civic Symphony Orchestra.
	Reading	Albright College Symphony Orchestra.
	do	Reading Symphony Orchestra.
	do	Sinfonette.
	Scranton	Scranton Philharmonic Orchestra.
	Selinsgrove	Susquehanna Symphonic Society.
	State College	College Symphony Orchestra.
	Sunbury	Sunbury Symphony.
	Swarthmore	Swarthmore College Orchestra.
	West Chester	Symphony Orchestra of State Teachers College.
	Wilkinsburg	Wilkinsburg Civic Orchestra.
	Williamsport	Williamsport Symphony Society, Inc.
	York	York Symphony Orchestra.
Rhode Island	Kingston	Rhode Island State College Orchestra.
	Providence	Brown-Pembroke Orchestra.
	do	Providence Community Sinfonietta.
	do	Rhode Island Philharmonic Orchestra.
South Carolina	Anderson	Anderson Symphony Orchestra.
	Charleston	Charleston Symphony Orchestra.
	Columbia	Columbia Music Festival.
	do	South Carolina Philharmonic Orchestra Society.
	do	Southern Symphony.
	Florence	Florence Civic Orchestra.
	Greenville	Greenville Symphony Orchestra.
	Spartanburg	Spartanburg Symphony.
South Dakota	Sioux Falls	Augustana Symphony Orchestra.
	Vermillion	University of South Dakota Symphony Orchestra.
	Yankton	Yankton College Conservatory Orchestra.
Tennessee	Chattanooga	Casale String Ensemble.
	do	Chattanooga Philharmonic Association, Inc.
	Cleveland	Bob Jones College Orchestra.
	Cookeville	Tennessee Technical Concert Orchestra.
	Kingsport	Kingsport Symphony Orchestra Association.
	Knoxville	Knoxville Symphony Society.
	Memphis	Southwestern Orchestra.
	Nashville	Nashville Symphony Orchestra.
	do	Nashville Youth Orchestra.
	Oak Ridge	Oak Ridge Symphony Orchestra.
Texas	Abilene	Abilene Christian College Symphony.
	Amarillo	Amarillo Philharmonic Orchestra.
	Austin	Austin Symphony Society.
	Belton	College Orchestra.
	Brownwood	Howard Payne College Orchestra.
	Corpus Christi	Corpus Christi Symphony.
	Dallas	Dallas Symphony.
	do	Southern Methodist University Student Symphony.
	Denton	North Texas State Symphony Orchestra.
	El Paso	El Paso Symphony Orchestra.
	Forth Worth	Fort Worth Chamber Orchestra.
	do	Forth Worth Symphony Orchestra.
	do	Texas Wesleyan College Orchestra.
	do	University Symphony Orchestra.
	Georgetown	Southwestern University Sinfonietta.
	Houston	Houston Symphony Orchestra.
	Lubbock	Lubbock Little Symphony.
	San Antonio	Incarnate Word College Orchestra.
	do	San Antonio Chamber Music Society.
	do	San Antonio Symphony.
	Waco	Baylor University Symphony Orchestra.
	do	Waco Symphony Orchestra.
	Wichita Falls	Wichita Falls Symphony Orchestra.
Utah	Cedar City	Branch Ag. College Symphony Orchestra.
	Logan	Utah State Symphony Orchestra.
	Provo	Brigham Young University Orchestra.
	do	Intermountain Symphony.
	St. George	Dixie College Orchestra.
	Salt Lake City	McCune School of Music Symphony Orchestra.
	do	Shepherd-Booth Sinfonietta.
	do	University of Utah Symphony Orchestra.
	do	Utah State Symphony Orchestra Association.

Listing of professional, nonprofessional, civic, amateur, college, and college-civic symphony orchestras in the United States; Aug. 1, 1951—Continued

State	City	Orchestra
Vermont	Middlebury	Vermont State Symphony.
Virginia	Arlington	Arlington Civic Symphony.
	Bristol	Bristol Civic Symphony.
	Charlottesville	University of Virginia Orchestra.
	Lynchburg	Lynchburg Civic Symphony.
	Norfolk	Norfolk Symphony Orchestra.
	Petersburg	Virginia State College Little Symphony.
	Richmond	Richmond Symphony Orchestra.
Washington	Aberdeen	Aberdeen High School Symphony Orchestra.
	Bellingham	Bellingham College-Civic Orchestra.
	Bremerton	Bremerton Symphony Orchestra.
	Everett	Everett Symphony Orchestra.
	Pullman	State College of Washington Symphony Orchestra.
	Seattle	Seattle Symphony.
	do	University of Washington Symphony Orchestra.
	Spokane	Spokane Philharmonic Association.
	do	Whitworth College Orchestra.
	Tacoma	College of Puget Sound Symphony Orchestra.
	do	Tacoma Philharmonic Orchestra.
	Walla Walla	Walla Walla Symphony Orchestra.
Washington, D. C.		Mount Vernon Orchestra.
		National Gallery Orchestra.
		National Symphony Orchestra.
		U. S. Department of Agriculture Symphony Orchestra.
		Washington Missionary College Sinfonietta.
West Virginia	Bluefield	Bluefield Symphony Orchestra.
	Charleston	Charleston Symphony Orchestra.
	Clarksburg	Clarksburg Symphony Orchestra.
	Fairmont	Fairmont Symphony Orchestra.
	Huntington	Huntington Symphony Orchestra.
	do	Marshall College Symphony Orchestra.
	Morgantown	West Virginia University Community-Symphony.
	Parkersburg	Parkersburg Symphony Orchestra.
	Salem	Salem College Orchestra.
	Wheeling	Wheeling Symphony Orchestra.
Wisconsin	Antigo	Antigo Cosmopolitan Orchestra.
	Appleton	Valley Symphony.
	Clintonville	Clintonville Civic Orchestra.
	Fond du Lac	Badger Symphony Orchestra.
	Kenosha	Kenosha Symphony Orchestra.
	LaCrosse	LaCrosse Civic Symphony Orchestra.
	do	LaCrosse Youth Symphony.
	Madison	Madison Civic Symphony Orchestra.
	do	University of Wisconsin Symphony Orchestra.
	Milwaukee	Milwaukee Symphony Philharmonic Association.
	do	Milwaukee Sinfonietta.
	Racine	Racine Symphony Orchestra.
	Sheboygan	Sheboygan Civic Orchestra.
	Waukesha	Waukesha Symphony Association.
	Wausau	Wausau Symphony Orchestra.
Wyoming	Casper	Casper Civic Symphony, Inc.
	Cheyenne	Cheyenne Little Symphony.
	Laramie	University Symphony Orchestra.

Senator BYRD. Mr. Myers.

STATEMENT OF ABRAM F. MYERS, COUNCIL OF MOTION PICTURE ORGANIZATIONS, WASHINGTON, D. C.

Mr. MYERS. Mr. Chairman, and gentlemen of the committee, my name is Abram F. Myers. I reside in Washington, D. C., and I represent the Council of Motion Picture Organizations. The Council of Motion Picture Organizations is an all-industry organization, representing all branches of the motion-picture industry.

A number of witnesses from our industry registered to be heard, and in response to your request, we have consolidated them into one and I have undertaken——

Senator BYRD. You will make the presentation?

Mr. MYERS. Yes, sir; except as Mr. Thalhimer might want to supplement my statement or pick up some point that I miss.

From now on, the act is going to be a little different because you now have a witness who is going to advocate the elimination from the bill of provisions which would cost the Government a great deal of revenue, instead of asking for special favors for our business.

I appear in opposition to section 402 of this bill, H. R. 4473.

The declared purpose of that section is to reinstate certain prewar exemptions from the admissions tax. We shall later see how misleading that declaration is.

Section 402, if enacted, would enable every religious institution, that is, every church, Sunday School or organization thereof, every educational institution, every school and college in the United States, every charitable institution, every society for the prevention of cruelty to children or animals, every society conducted for the sole purpose of maintaining a symphony orchestra, every national guard or Reserve officers organization, every organization and post of war veterans and the auxiliaries or societies thereof, and the police and fire departments of every city, town, village, or municipality to conduct amusement enterprises, including motion-picture shows, without having to add to the price of admission the 20 percent Federal admissions tax.

By far, the most serious provision—and this is the unkindest cut of all—is the one which would grant immunity from the admissions tax of societies or organizations conducted for the sole purpose of maintaing a cooperative or community moving-picture theater.

The committee will note that there is no requirement that such an organization or society shall have any connection with any religious, educational, or charitable activity. The only limitation is with respect to participation in the net earnings, which may not inure to the benefit of any stockholder or individual.

That same limitation applies to the exemptions to be granted to the religious, educational, and charitable organizations, and so forth, but it is wholly ineffective.

In fact, the section if adopted, will open up a promoters' paradise. I need not remind the committee that before there can be any net earnings, costs and expenses must be paid. The main items of cost invariably are the promoters' fees and expenses. They must be deducted from the moneys received, and the remainder, if any, would inure wholly for the benefit of the institutions involved, in literal compliance with the section.

Let me cite a possible example which will bring this point home to the committee. I hope with all my heart and soul this will not happen, but it could.

A hard-pressed motion-picture exhibitor, struggling to remain in business—and most of them still are—might welcome the chance to turn his theater over to some religious, educational, or charitable institution or a group organized to maintain a cooperative or community center moving-picture theater in return for a satisfactory employment contract as manager.

His salary, plus a net profit to the beneficiary, may be secured out of the tax savings afforded by this bill. That is the kind of competition to which the established motion-picture theaters would be subjected—pardon me; is there a limitation that you want me to observe especially?

Senator BYRD. We do not want to limit you unreasonably but be as concise as you can.

Mr. MYERS. I know one never makes any progress by overstepping his bounds.

Senator BYRD. Take sufficient time. You have an important presentation.

Mr. MYERS. Thank you, sir.

His salary, plus a net profit to the beneficiary, might easily be secured out of the tax savings afforded by this bill. That is the kind of competition to which the established motion-picture theaters would be subjected by the provisions of this bill.

Let us not mince words; this is a proposal to grant a Federal subsidy to all manner of entertainment enterprises conducted in large measure for the enrichment of promoters, to all manner of fly-by-night operators in order to give them a competitive advantage equal to 20 percent of the price of every ticket sold, over the legitimate, established business.

The provisions in question are vicious for two reasons: They would grant subsidies to favored enterprises—favored entertainment enterprises in violation of fundamental principles of our Government, and at the same time, would oppress and threaten legitimate enterprises, and endanger the revenue now being derived from taxpayers—and this at the moment when the Government needs all of the revenue that it can lay its hands on for the national emergency.

I was refreshed by the candor of the last witness. She said very frankly that the savings resulting from the granting of these exemptions would be pocketed by these institutions. Now, whose money is it? They do not pay—the amusement enterprises do not pay this tax; it is paid by the person who buys the admission to the place of entertainment.

I have been before the Ways and Means Committee and before this committee a good many times with respect to this amusement tax, and always I have been confronted with this question, "What do you propose to do with that money? Are you going to pass on the benefit of a reduction or repeal of the tax to the customers whose money it is, or are you going to pocket it?"

Last year, when the motion-picture industry was in the direst extremities, and I was before this committee and the House committee, asking for relief, I had to answer that question and I prepared myself in advance in this way: All the major theater circuits agreed they would pass on the benefit to their customers, and the great majority of the smaller theaters through their theater associations pledged the same thing, but here there is no such suggestion.

We hear much said in praise of private enterprise, individual initiative and free and open competition.

These sentiments are even voiced by the public-spirited men who organize uplift societies and the fund-raising schemes for their support; that is to say, they utter those sentiments in reference to their own private business operations, and rather lose sight of them when their hobbies are affected.

Yet, what is here proposed is that religious, educational, and charitable institutions, all manner of veterans' organizations, and local and police and fire departments in the conduct of commercial enterprises shall be given a bounty.

I want to deal briefly with the declared purpose of section 402 to reinstate certain exemptions formerly contained in the Internal Revenue Code; that heading affords the text for the arguments in support of the section, namely, that this is not an innovation, but a mere restoration; that since the movies survived under the unfair competition thereby created before the war, they can do so again.

While the provisions of section 402 are similar to those formerly contained in the code, with one notable embellishment and change in wording and arrangement, there is no compensating general exemption of all admissions, including movie admissions, below a certain sum, such as that which prevailed throughout this time that the special exemptions were in operation.

I have prepared a formal statement which goes into this matter in detail. The time allotted to me will permit but a brief summary, and I respectfully ask that the formal statement be inserted into the record immediately following my testimony.

Senator BYRD. That will be done, Mr. Myers.

Mr. MYERS. For present purposes, it will suffice to say that at the time these special exemptions were first adopted, and that was in 1924, the Congress, in order to avoid discrimination, exempted from the tax all admissions of 50 cents or less including movie admissions.

In those days of silent pictures, low production, and operating costs, and sound money, there were few, if any, movie admissions of more than 50 cents, except an occasional road show.

In succeeding years the exemption was raised to 75 cents and then to $3 so that for a number of years the movies were wholly exempt, and the special exemption meant nothing competitively.

In 1932, in order to raise revenue for pump-priming purposes, Congress lowered the general exemptions to include only tickets of less than 41 cents.

This affected a good many big-city downtown theaters, but even so, it left most neighborhood and small-town theaters, a majority of the theaters, untaxed.

In 1941, in the teeth of World War II, Congress abolished all exemptions, both general and special. The sound idea back of this was that all diversion seekers should bear their fair share of the tax burden, and that there should be special favors to none.

The loss of the 40-cent exemption hit a lot of small theaters but attendance then was at its peak.

In 1943 the tax rate was doubled from 10 percent to 20 percent, but business was still good, and with the country in the midst of a desperate war, no one protested.

Now, it is proposed to restore the special exemptions with an embellishment, at a time when the movies, in common with all other spectator amusements, are suffering, when the tax is double what it was when the special exemptions were formerly in force, and without any compensating general exemption such as prevailed throughout the time that the special exemptions were in effect.

Senator BYRD. Have you got any figures on the loss of business by the motion-picture industry?

Mr. MYERS. Not combined figures but they are best reflected in the constantly dwindling receipts from the admissions tax.

Senator BYRD. I mean, what percentage do you think it is?

Mr. MYERS. Oh, anywhere from 25 to 45 percent over the wartime peak. The Internal Revenue Bureau's tax figures cover all spectator amusements, but they reflect the trend generally. Baseball also is badly hit.

The constantly dwindling revenue from admissions taxes tells the story.

I was amused to read in the Wall Street Journal that an official of the St. Louis Cardinals baseball team, in view of the dwindling purchase price of the dollar, said: "The public would evidently rather see a meat plate than a home plate."

Senator BYRD. Has television expansion hurt the movies?

Mr. MYERS. It has undoubtedly hurt all spectator amusements. Television carries no admissions tax.

I have heard the word "embellishment," and perhaps I had better explain that.

Prior to 1941 there was an exemption in favor of members of fire and police departments, their families and heirs. Obviously, that was to cover, or intended to cover, benefit performances for pension funds, relief funds, and the like.

Now, that is changed in the present bill—and this is noteworthy—so as to exempt shows and entertainments for the benefit of the fire department and the police department themselves.

Thus, under this provision, we would be treated to the spectacle of the Federal Government granting a subsidy to a local fire department in the form of tax exemption to enable it to buy a new fire engine; this, if the committee, pleases, in the teeth of all the outcries against Federal encroachment or State abdication, however you want to view it, and is shocking to those of us who feel that the Federal Government should remain within the reasonable limits of its delegated powers.

In considering the special plans made in behalf of those who would benefit from the passage of this bill, this committee should not overlook the fact that the motion pictures also are worthy and make an important contribution to the general welfare.

They afford high-grade entertainment not merely to the intelligentsia and the dilettante, but to the masses and at a prices the masses can afford to pay.

There is something incongruous to my mind about taxing a child's 25-cent admission to a theater and exempting a $20 opera ticket, much as I should like to see culture spread over the length and breadth of the land.

Senator KERR. Did I understand you to say which of these groups you thought Congress was in? Is that what you said?

Mr. MYERS. I beg your pardon, sir?

Senator KERR. Did I understand you to say which of these groups you thought Congress came under?

Mr. MYERS. I think definitely in the eleemosynary institutions class.

Senator KERR. You are talking about the institution now, not the Members.

MYERS. That is right. [Laughter.]

Motion pictures are fashioned to the public taste, and include in the yearly programs western, mystery plays, comedies, drama, and musicals.

Much also has been said about the diffusion of culture by operas and symphonies. I detract nothing from their value in that respect.

I remind the committee now, though, that what used to be Lem Underdunk's Silver Cornet Band in the village now has blossomed out into a symphony orchestra and the exemptions here will probably be greater than you anticipate.

There have been a number of picture featuring symphony orchestras and opera singers. Mario Lanza's rendition of operatic arias in that magnificent picture, The Great Caruso, probably did more to stimulate the love for good music than—but I forbear to be invidious.

On the cover of Time magazine this week you will see Mr. Lanza's picture and a big article about that feature film.

The motion-picture industry's great contributions to the war effort in two World Wars and its support of all manner of worthy causes and charities have been described to this committee on other occasions and need not be repeated here.

In contributing to the entertainment of the Armed Forces, our industry donated its product and talent, while others sold their wares for a price.

Despite a popular impression, the motion-picture industry and Hollywood are not synonymous.

Hollywood's accomplishments speak for themselves, and no criticism is implied by this distinction, but more important are the thousands of motion-picture theaters scattered throughout the length and breadth of the land.

These retail outlets are located in 9,600 cities and towns in the country. Over one-third of the movie theaters are located in small towns and villages of 25,000 population and under. This is sound, everyday American business. It is also small business.

The average seating capacity of theaters in the United States is 648. Over half of the theaters have 500 or less seats, and those in the small towns average only 339 seats.

These theaters represent 94 percent of the total investment in the motion-picture industry. They employ upwards of 140,000 people.

The motion-picture exhibitor is like every other Main Street merchant. As a citizen, taxpayer, employer, he is indistinguishable from the corner druggist or grocer. There is no more reason to discriminate against him and subsidize his competitors than there is to accord like shabby treatment to other merchants.

In conclusion, we ask that the unfair and discriminatory provisions in question be stricken from the bill; or, in the alternative, that equal treatment be accorded to the motion-picture theaters by including them in the exemption.

Thank you.

Senator KERR. You want them either to take down the tent or make it big enough for you to get into, too?

Mr. MYERS. Yes, sir.

But times being what they are and the Government's necessities being what they are, it might be better to take down the tent.

Senator BYRD. Thank you, sir.

(Mr. Myers' prepared statement follows:)

STATEMENT BY ABRAM F. MYERS IN BEHALF OF COUNCIL OF MOTION PICTURE ORGANIZATIONS

EXPLANATORY NOTE

I appear as the authorized spokesman for the Council of Motion Picture Organizations. The council, commonly called COMPO, is an all-industry organization representing in the public-relations field all industry branches—production, distribution, and exhibition.[1]

In the preparation of this statement I have had the advice and assistance of an able and experienced advisory committee, thoughtfully provided by COMPO, whose suggestions and views are reflected herein.[2]

Our position is that section 402 granting special exemptions from the admissions tax to certain favored organizations and institutions should be stricken from the bill. If that is not done, then we ask that the motion-picture theaters also be freed from the tax.

Just a little over a year ago (July 7, 1950) Gael Sullivan and I appeared before the Finance Committee seeking relief from the admissions tax for the motion-picture theaters. We presented ample proof of the depressed state of the motion-picture business and, as we thought, made out an iron-clad case for the theaters.[3] But when the seriousness of the Korean situation became known, and it became apparent that taxes would have to be increased instead of lowered, the motion-picture industry decided that it would be unpatriotic to continue the struggle for relief. Thereupon the effort was abandoned, the Senators and Congressmen who had offered encouragement were thanked for their interest, and the COMPO tax committee, of which I was chairman, was disbanded.

For this we received numerous letters of appreciation and commendation, and we felt that we had followed the proper course.

Since then conditions in the motion-picture business have improved but little, and in some areas conditions are worse. If the Congress is now going to grant special exemptions from the admissions tax on grounds of economic need, then motion pictures qualify for first consideration. Indeed, if it were not for the grave dangers which beset the Nation, with the resulting drain on its resources in providing for the national defense, the motion-picture industry would now be renewing its pleas for abatement of the admissions tax.

Other interests in the field of entertainment have not felt the same compunction about seeking special consideration in time of national peril. As a result there have been written into H. R. 4473 provisions for exempting a variety of such enterprises from the admissions tax. These special exemptions, if enacted into law, would give those enterprises an unfair competitive advantage over the established motion-picture theater. They constitute rank discrimination and lead to the inference that, in the view of Congress, motion pictures—the Nation's basic entertainment—are less essential to the public interest than these specially favored enterprises.

THE OBJECTIONABLE PROVISIONS

Our objections center upon the provisions of section 402 (pp. 104–106 of the Senate print) which, according to the heading, are designed to reinstate the prewar exemptions from the admissions tax.

These exemptions were added piecemeal to the Internal Revenue Code between World War I and World War II as special groups pressed their claims upon Congress. They are to be found in section 1701 of the code, subsections (a) to (c) inclusive (26 U. S. C. A., sec. 1701).[4]

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[1] Allied States Association of Motion Picture Exhibitors, Independent Theatre Owners Association, Metropolitan Motion Picture Theatres Association, Motion Picture Association of America, Motion Picture Industry Council, Pacific Coast Conference of Independent Theatre Owners, Society of Independent Motion Picture Producers, Theatre Owners of America, the Committee of Trade Press Publishers, Variety Clubs International.

[2] Trueman T. Rembusch, president of Allied States Association of Motion Picture Exhibitors; Gael Sullivan, executive director of Theatre Owners of America; Oscar A. Doob, of the theater department, Loew's, Inc.; A. Julian Brylawski, president of Motion Picture Theatre Owners of the District of Columbia; Robert W. Coyne of COMPO. My position in the industry is that of chairman of the board of directors and general counsel of Allied States Association of Motion Picture Exhibitors.

[3] Hearings on H. R. 8920, Revenue Revisions of 1950, pp. 146–161; see also hearings before Ways and Means Committee on the same subject, February 21, 1950, pp. 1794–1800.

[4] Derivations—Subsec. (a): Religious, educational, or charitable entertainments from Revenue Act of 1924 (26 U. S. C. A., volume containing Internal Revenue Acts 1924 to 1939, pp. 90–91). Subsec. (b): Agricultural fairs from same source as above. Subsec. (c): Certain concerts added by Revenue Act of 1932 (26 U. S. C. A., volume containing Internal Revenue Acts 1924 to 1939, p. 956).

With one notable addition and one omission, and with minor changes in wording and arrangement, the exemptions conform to those formerly contained in section 1701 of the code.

These accumulated exemptions were terminated by the Revenue Act of 1941.[5] The obvious purpose of the repeal was to ease upon the patrons of all forms of entertainment their fair share of the tax burden incident to the preparation for war, the Nation then, as now, being in a state of crisis. Also it is reasonable to suppose that Congress took into account the fact that, by the same act, the exemption of all admissions of less than 41 cents, which had prevailed since 1933, also was terminated.

By section 402 of the bill section 1701 (a) of the Revenue Code would be amended to exempt from the tax any admissions all the proceeds of which inure—

"(A) exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, societies for the prevention of cruelty to children or animals, or societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions or of maintaining a cooperative or community center moving-picture theater—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

"(B) exclusively to the benefit of National Guard organizations, Reserve Officers' associations or organizations, posts or organizations of war veterans, auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private stockholder or individual; or

"(C) exclusively to the benefit of a police or fire department of any city, town, village, or other municipality, or exclusively to a fund for the sole benefit of members of such a police or fire department or the dependents or heirs of such members.

"(D) (New.) Any admissions to swimming pools, bathing beaches, skating rinks, or other places providing facilities for physical exercise, operated by any State or political subdivision thereof or by the United States or any agency or instrumentality thereof if the proceeds therefrom inure exclusively to the benefit of the State, political subdivision, United States agency, or instrumentality. For the purpose of this subsection the term 'State' includes Alaska and Hawaii and the District of Columbia."[6]

The vast number of institutions and individuals who, under these provisions, could carry on enterprises involving the charging of admission fees without collecting an admission tax, and wide variety of tax-free entertainment and recreational enterprises that would be encouraged to enter into competition with the theaters, will be discussed under a subsequent heading. The only enterprises to which the exemption would not apply are—

"(A) any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school;

"(B) wrestling matches, prize fights, or boxing, sparring or other pugilistic matches or exhibitions; or

"(C) carnivals, rodeos, or circuses in which any performer or operator participates for compensation."[7]

Except for these three enumerated classes, the fortunate beneficiaries of the Government's bounty will be free to carry on any form of entertainment or recreational enterprise in competition with the motion-picture theaters and will not be hampered by the requirement that they add 20 percent to the price of every ticket sold as an admission tax.

A BLOW TO PRIVATE ENTERPRISE

The admission tax, it must be remembered, is paid by the person paying for the admission.[8]

When the theaters sought relief from the tax their representatives informed the Congress that the great circuits directly, and most of the independent theaters through their associations, had agreed to pass on the benefit of the

[5] 26 U. S. C. A., volume containing Internal Revenue Acts beginning 1945, pp. 123–124.

[6] By sec. 403 these exemptions will become effective on the first day of the first month which begins more than 10 days after date of the bill's enactment—about the time that staggering increases in individual and corporate income taxes go into effect.

[7] These exceptions to the proposed exemption are set forth in par. (2) of sec. 402 (b).

[8] Sec. 1700 (a) (2), Internal Revenue Code.

repeal of the tax or lowering of the rate to their customers. In other words, it was recognized that the tax money was the patrons' money and that it would not be proper for the theaters to take advantage of such congressional action by raising admission prices, thus absorbing all the benefit.

The position of the theaters was that repeal of the tax would result in a 20 percent decrease in the total cost of an admission and that this would attract more patrons into the theaters.

The position of those who have caused the exemptions to be written into the present bill and will be the beneficiaries thereof is in strange contrast to that taken by the theaters. To the extent that they are now regularly engaged in conducting amusement enterprises and have established admission prices, their arguments plainly imply that they themselves propose to take advantage of their exemption from the tax and thus increase their gross box-office receipts by 20 percent. If there has been a disavowal of such purpose it has not come to our attention.

As regards the other prospective beneficiaries not now regularly engaged in such enterprises, they admittedly are out to raise money for their religious institutions and favorite charitable and welfare organizations, for their National Guard and veterans' organizations, and for their police and fire departments. What they want, and what under this bill they will receive, is a Government subsidy—a 20 percent advantage in the total admission charged over the private enterprises which must compete with them.

The religious, educational, and welfare organizations which will receive this subsidy are of the class that traditionally are supported by voluntary contributions. The fire and police departments in the past have been and properly should be supported by local assessments.[9] When these organizations invade the field of commerce and compete for the leisure time and patronage of the diversion-seeking public, they should pay the same taxes and assume the same burdens as others so engaged.

Lip service is constantly being paid to those foundation stones of the American way of life—private enterprise, individual initiative, and the competitive system—even by the public-spirited men and women who organize these fund-raising schemes. Yet they are in effect proposing that religious and educational institutions, local charities and welfare organizations, all manner of veterans' organizations and activities, and municipal services shall become the beneficiaries of a Federal bounty.

If it be thought that we are overstressing this matter, let me pose this question to any member of the committee: What would be your feeling if you were dependent upon a motion-picture theater for your livelihood and, perhaps, had your life's savings invested in it, and in the conduct of your business you were required by the Government to collect from every patron and remit to it a sum equal to 20 percent of the admission price paid, and then the Government decided that every church, school, and college, every charitable, welfare, and veterans' organization, and the police and fire departments should have the right to engage in competition with you by selling entertainment in your community without adding the tax to the admission prices charged by them?

The unkindest cut of all is the exemption granted to any organization or society conducted "for the sole purpose * * * of maintaining a cooperative or community center moving picture theater." There is no requirement that such an organization or society shall have any connection with any religious, educational, or charitable activity. The only limitation is with respect to participation in the "net earnings" which may not inure to the benefit of any stockholder or individual. But this intended protection, as we shall later see, is a mere chimera; this provision is, in fact, commercialism rampant.

Justification for these special favors cannot be found in the worthiness of the putative beneficiaries. Congress has approached with the greatest caution the problem of Federal support for schools. That subject involves serious difficulties and perhaps is fraught with grave dangers. The schools are tax-supported now on a local or State level. The theaters by paying their taxes already bear their share of the burden. By what reasoning can a Federal subsidy be added

[9] Sec. 402 (b) contains an innovation, the significance of which should not be overlooked. Prior to 1941 the code provided an exemption for admissions "exclusively for the benefit of members of the police or fire department" of any city, town, village, etc. This limited the exemption to entertainments given in the interest of pension and relief funds, etc. Under the bill it would extend to shows "exclusively for the benefit of a police or fire department" as well as the members of such department. Thus a tax-free show could be given for the purpose of buying a new fire engine.

to this help, especially when it works rank discrimination against legitimate commercial enterprises? Delicate questions also are involved in the granting of special favors to churches and private charities. But no matter how worthy the ultimate beneficiaries may be (assuming there are any benefits after costs and expenses have been paid), the proposed exemptions constitute a blow to private enterprise and deserve to be repudiated on that ground alone.

INVITATION TO FLY-BY-NIGHTS

However high-minded the purposes of the supporters of these exemptions, there lurks behind them a group of greedy promoters who expect to and will reap rich pecuniary rewards notwithstanding the protective language written into the bill.

All of us in show business know as a practical matter and on the basis of experience that fund-raising schemes more often than not are organized and carried on in the name and (in varying degrees) for the benefit of religious, educational, and charitable institutions by professional promoters.

Disregarding Sunday school and grade and high school performances put on by the scholars themselves, it is accurate to say that no entertainment worthy of an admission price can be presented without the assistance and know-how of persons experienced in such matters. The "proceeds" of these affairs may inure wholly to the benefit of the institution in question and no part of the "net earnings" will go to any stockholder or individual—all as provided in the bill. "Proceeds" as used in the bill quite obviously is not synonymous with gross receipts. If it were, then the concluding clause to each paragraph, referring to "net earnings," would be meaningless. Moreover, any such enterprise necessarily incurs expenses, and these must be deducted before there can be any proceeds. Therefore, the bill allows ample scope for profitable promotional operations.

Take a typical example such as most of us have encountered in our experience. The telephone rings and an attractive voice informs us that some church, school, or charitable institution or veterans' post is giving an entertainment and "won't you please buy some tickets?" Back of that solicitation stands a professional promoter with an organization skilled in this sort of work. The promoter first approached the institution and proposed to stage an affair for its benefit. He supplies the entertainers, the solicitors, and the equipment and paraphernalia and stages the performance. He is paid out of the gross receipts—that is the "cost" of the undertaking and whatever is left over inures to the benefit of the institution.

There are many variations of the routine but the schemes all boil down to the same thing—the enrichment of the professional promoters.

They operated profitably under the exemption when the admission tax was only 10 percent of the admission price. The practice decreased noticeably when all exemptions were repealed. Since then the tax has been doubled and so will be the temptation to promote tax-exempt shows. A 20 percent price advantage is a compelling force. While I hope that the motion-picture exhibitors will engage in no such shenanigans, it must be recognized that the bill offers strong inducements for them to make certain business arrangements which would bring their theaters within the tax-exempt class.

A hard-pressed exhibitor, struggling to remain in business, might welcome the chance to turn his theater over to some religious, educational, or charitable institution, or to a group organized to maintain a cooperative or community center moving-picture theater, in return for a satisfactory employment contract as manager. His salary plus a net profit to the statutory beneficiary doubtless could be insured out of the tax savings afforded by the provisions of the bill. As the agency of such an institution, it is conceivable that the theater would also be relieved of the burden of paying property taxes and other local assessments.

It is the established businesses, not the itinerants, fly-by-nights, and once-in-awhile operators, who bear the tax burden and insure the solvency of the local, State, and National Governments. Motion-picture theaters are taxed far beyond most businesses. They are paying all the taxes levied on business enterprises in general, plus special taxes, fees, and assessments peculiar to their business. It is unnecessary to recount to this committee the many Federal taxes, direct and indirect, which they must pay. In addition they must pay all or part of the 12 State and local taxes listed at the bottom of the page.[10]

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[10] (1) Income, (2) real estate, (3) personal property and intangibles, (4) unemployment, (5) occupational taxes and licenses, (6) special assessments, (7) school, (8) road, (9) fire inspection, (10) signs and marquees, (11) billboards, (12) State excises.

The admission taxes to be relinquished to the beneficiaries described in the bill are not an accurate measure of the loss of tax revenue that will ensue if the bill is passed. When patronage is drained from the theaters by tax-free competitors, the public revenues—local, State, and national—all suffer. And when a theater fails, there only remains a diminishing real estate tax as theaters are so constructed that they cannot be readily converted to other uses.

THE DANGER IS REAL, NOT IMAGINARY

While exact figures are not available to us, we cannot resist challenging the estimate of $16,000,000 as the amount of revenue which will be lost to the Government if these proposed exemptions are enacted into law. It is quite obvious, we think, that much more than $80,000,000 a year is spent on so-called nonprofit amusements. Even so, $16,000,000 would come in handy for building warplanes at a time when the Government so badly needs every penny of revenue it can lay its hands upon.

Moreover, the estimate applies only to existing nonprofit entertainments, it does not take into account the many such enterprises that will be stimulated into activity once the exemptions become effective.

We have not had the time, nor do we have the facilities, for a complete Nation-wide survey of the theaters and auditoriums owned or operated by institutions of the kind that would become tax-exempt under the bill. The results of such a survey, should it be made, would be startling and would surely give pause to those who have the interests of the Government at heart and are devoted to the principle of free enterprise.

A report which we have received from New Jersey lists the following affairs which have taken place in Hudson County and which would be tax-exempt under the bill:

1. Sister Kenny Fund, roller-skating derby, Jersey City Armory, capacity 5,000.
2. Jersey City Symphony, five concerts each year, subscription price $10 a year.
3. Sacred Heart Church, vaudeville, Snyder High School, capacity 2,000, admission price $1.
4. St. Michaels Church, vaudeville, Public School No. 37, capacity 1,200, admission price 75 cents.
5. Church of Christ the King, vaudeville, Snyder High School, capacity 2,000, admission $1.
6. St. Patricks Church, vaudeville, Snyder High School, capacity 2,000, admission $1.
7. Catholic Youth Organization, horse show, Roosevelt Stadium, capacity 15,000, prices 50 cents and $1.
8. Mount Carmel Church, vaudeville, Public School No. 23, capacity 1,200, price 75 cents.
9. Albert Quinn Post, AWV, carnival, Roosevelt Stadium, capacity 15,000, percentage basis.
10. High-school-football games, school fields, students admission 25 cents, adults $1.
11. High-school championship (1 game), Roosevelt Stadium, capacity 15,000, admission $1.
12. St. Paul's of the Cross Church, auditorium, capacity 1,000, admission $1.

The foregoing is a random report from the many sent in by motion-picture personnel located in the cities dealt with in the reports. The facts stated are a matter of every day observation in every city and town in the country. Next we come to a frightening statement based upon the returns to questionnaires sent to 536 colleges and universities inquiring about motion-picture shows given in their auditorium. Three hundred and sixty-four replied.

I have the report with me but it is too long to set forth in this memorandum. It shows that the total number of seats contained in these auditoriums is 137,882. The total number of shows given during the school year was 1,590. One hundred and thirty-nine institutions reported that they now limit attendance to students only. The remaining two-thirds admitted others than members of the faculty and the student body. Many of these colleges are located in small towns and, therefore, close to existing theaters.

Who knows how many church, grade school, and high school auditoriums there are which, if not already presenting shows of one kind or another, will attempt to do so if the admissions tax is lifted from their shoulders and is allowed to remain a burden upon the motion-picture theaters. The danger is imminent and real both to private enterprise and to the Government's revenues and is not to be shrugged off by proponents of the exemptions, jubilant over their great expectations.

TIMES HAVE CHANGED

The proponents of these exemptions argue that the same constitute a mere restoration, not an innovation; that since the motion-picture business survived the unfair competition imposed thereby in the past, it can continue to survive in the future.

While the proposed exemptions are pretty much the same as those that were in effect between 1924 and 1941, conditions within the motion-picture business and generally have so changed that reinstatement of the exemptions now would threaten the very existence of the motion-picture business.

In 1924 when the exemptions were first granted motion pictures were a fast-growing, healthy, happy business, sitting on top of the world. The admission tax then, and up until 1943, was only 10 percent. Not only was the rate only half what it is today, but all admissions of 50 cents or less, including movie admissions, were exempted.[11]

In those early days of silent pictures, low production and operating costs and sound money, admission prices were considerably lower than they are today. It is fair to say, therefore, that that exemption included all movie admissions except those charged for a small number of road shows and special attractions.

In other words, when Congress first granted these special exemptions to religious, educational, and charitable institutions, and to the members of police and fire departments, it was careful also to exempt movie admissions, to all intents and purposes.

In 1926 Congress raised the general exemption to include all admissions, including movie admissions, of 75 cents or less.[12]

And in 1928 the general exemption was raised so as to include all admissions of $3 or less.[13]

Thus the movies enjoyed a practical immunity from the admissions tax from the time the special exemptions were first adopted until 1932.

In 1932, in the midst of the depression, Congress was compelled to increase taxes in order to support the pump-priming program, and one of the expedients was to lower the general exemption to include admissions of less than 41 cents, but the rate remained at 10 percent.[14] But even with this lowered general exemption, most movie admissions were still included therein, as admissions of more than 40 cents usually were confined to the downtown theaters in the larger cities.

In 1941, in the teeth of World War II, Congress abolished the general exemption, except as to children's admissions of less than 10 cents, and at the same time abolished all the special exemptions, including the exemption of admissions to the national parks and monuments.[15]

This wiped the slate clean of all exemptions, with the single exemption above noted, and the tax was made to apply to the first penny of admission price paid. The loss of the exemption of 40-cent admissions was a serious one for the small theaters, but it came at a time when theater attendance was at the peak and, good citizens that they are, the exhibitors accepted it without a whimper.

In 1943 Congress added the war rates to the various excises and the admissions tax was doubled (from 10 to 20 percent). This also came at a time when the picture business was enjoying a high degree of prosperity, and for our encouragement (and subsequent disappointment), the act provided that the war rates should end 6 months "after the date of the termination of hostilities in the present war." [16]

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[11] U. S. C. A., volume Internal Revenue Acts, 1924 to 1939, p. 90.

[12] U. S. C. A., volume Internal Revenue Acts, 1924 to 1939, p. 269.

[13] Ibid., prize fights enjoyed the $3 exemption but admissions to fights costing $5 or more were taxed at the rate of 25 percent instead of 10 percent.

[14] Ibid., p. 270.

[15] Act of March 7, 1941, U. S. C. A. volume, Internal Revenue Acts beginning 1940, pp. 123–124.

[16] U. S. C. A. volume, Internal Revenue Acts, beginning 1940, p. 470. This promise of postwar relief was withdrawn by the Excise Tax Act of 1947, 26 U. S. C. A., volume Internal Revenue Acts, beginning 1940, Supp. p. 16.

The war rates we still have with us, notwithstanding movie attendance has declined to the lowest ebb in many years. The conditions which proponents of these special exemptions cite in support of their demands are the very same conditions which are affecting the movies. They urge changed conditions as regards increasing costs and declining receipts as a reason for bestowing on them a competitive advantage over the movies, but ignore the fact that those changed conditions have affected the movies as much as themselves.

The remarkable fact revealed by this review is that throughout the history of the admissions tax Congress has scrupulously avoided discriminating against the motion-picture business insofar as exemptions are concerned. The present bill, if enacted, would constitute a departure from Congress' traditional policy of fair treatment for all in this regard. Reinstatement of the special exemptions, without raising the general exemption to include movie admissions, would not be a restoration of conditions prior to 1941 but on the contrary would be a violent innovation violative of American principles of free enterprise and fair play.

PANDORA'S BOX

The demands of the State and local governments and of various causes for Federal aid have increased to a point that is alarming to those who think that Congress should operate within the boundaries of its delegated powers.

The provisions of section 402 of the present bill, viewed in the light of present conditions, portend a new and even more mischievous trend toward Federal encroachment or State abdication (whichever way one chooses to regard it) than any we have thus far encountered.

Special tax favors cannot be granted to a few without injuring or exciting the cupidity or jealousy of others. Moreover, the conditions mentioned under the preceding heading are adversely affecting virtually all spectator amusements. This is shown by the gradual decline in admission tax receipts. A special article in the Wall Street Journal for July 30, headed "Ball park attendance continues to drop," shows that last year baseball attendance dropped 16 percent from the peak of 1948 and that present indications are there will be a drop of 10 percent this year from last.

An official of the St. Louis Cardinals is quoted as saying: "As the dollar value drops people would rather see a meat plate than a home plate."

We will not belabor this statement by speculating on the causes for the falling off in attendance at the movies, at the ball parks, at the circus and at the so-called highbrow entertainments. Our only purpose is to illustrate that these enterprises, whether carried on for a pecuniary profit or the compensations of conscious virtue, are in the same boat; and that, if Congress now grants relief to a favored few, it will soon hear from the neglected many. Enact this bill in its present form and beyond a shadow of doubt all other amusements will also be clamoring for exemption from the admissions tax.

The case of the municipalities and their fire and police departments calls for special attention. The mayors long have sought repeal of the Federal admissions tax so as to clear the way for the imposition of local admissions taxes. In this attempt they have been unsuccessful. Now they are seeking the same benefit in another way. They want to support their police and fire departments from the profits of tax-free shows and games. In substance, that amounts to appropriating money out of the United States Treasury to support local police and fire departments; and Congress should concern itself with the substance of the proposal and not be misled by the enticing garb in which it is clothed.

And if the municipalities continue to expand their activities and costs continue to mount and the purchasing power of the dollar continues to fall, it is inevitable that the mayors will be back on the doorstep of Congress asking for the exemption of entertainments and all manner of enterprises maintained and carried on for the support of other departments and services, possibly for the support of the municipal corporations without regard to any particular department or service.

SECTION 401 IS UNOBJECTIONABLE

Section 401 would have the effect to remove from section 1700 of the Internal Revenue Code the requirement that when a person is admitted free or at a reduced rate to any place where an admission fee is charged, there shall nevertheless be collected from such person an admission tax which is equivalent to the tax which would apply to one paying the established admission price for the same or similar accommodations.

It has never been clear why the Government should want to collect an admissions tax on money that is not spent, or more than the proportionate tax on the amount actually spent. The requirement is an unwarranted deterrent to the admission of students and men and women in the Armed Forces at reduced rates.

To illustrate, if the established price for an orchestra seat is 50 cents, the tax comes to 10 cents, making the total charge 60 cents. If the theater owner sees fit to admit a soldier or sailor free, he must nevertheless collect 10 cents from him and turn it into the Treasury. And if he sees fit to admit members of the Armed Forces or students for 25 cents, he must also collect a 10-cent tax instead of the proportionate 5 cents.

Sections 401 and 402 are not geared together in any way and we should like to see the former retained and the latter stricken.

MOTION PICTURES' CONTRIBUTION TO THE GENERAL WELFARE

In considering the special claims made in behalf of those who would benefit from the passage of the bill, this committee should not overlook the fact that motion pictures also are worthy and make important contributions to the general welfare.

They afford high-grade entertainment, not merely to the intelligentsia and the dilettanti, but to the masses, and at a price the masses can afford to pay.

Motion pictures are fashioned to the public taste and included in the yearly program are westerns, mystery plays, dramas, comedies, and musicals. Much has been said about the diffusion of culture by operas and symphonies. There have been a number of pictures featuring symphony orchestras and opera singers. Mario Lanza's rendition of operatic airs in that magnificent picture The Great Caruso probably did more to stimulate a love for good music than—but we forbear to be invidious.

The motion-picture industry's great contributions to the war effort in two world wars, and its support of all manner of worthy causes and charities have been described to this committee on other occasions and need not be repeated here. In contributing to the entertainment of the Armed Forces our industry donated its products and talent whilst others sold their wares for a price.

Despite a popular impression, the motion-picture industry and Hollywood are not synonymous. Hollywood's accomplishments speak for themselves and no criticism is implied by this distinction. But more important are the thousands of motion-picture theaters scattered throughout the length and breadth of the land. These retail outlets are located in 9,039 towns and cities. Over one-third of the movie theaters are located in small towns and villages of 25,000 population and under.

This is sound, every-day American business. Also it is small business. The average seating capacity of theaters in the United States is 643. Over half of the theaters (51.9 percent) have 500 seats or less, and those in the small towns average only 339 seats.

These theaters represent 94 percent of the total investment in the motion-picture industry. They employ upward of 140,000 people. The motion-picture exhibitor is like every other Main Street merchant. As a citizen, taxpayer, employer he is indistinguishable from the corner druggist or grocer. There is no more reason to discriminate against him and subsidize his competitors than there is to accord like shabby treatment to other merchants.

In conclusion, we ask that the unfair and discriminatory provisions in question be stricken from the bill or, in the alternative, that equal treatment be accorded the motion-picture theaters by including them in the exemption.

Senator BYRD. The next witness is an important citizen from Virginia, Mr. Morton G. Thalhimer, representing the Virginia Motion Picture Association.

Mr. Thalhimer, do you desire to address the committee? We will be delighted to hear from you.

STATEMENT OF MORTON G. THALHIMER, VIRGINIA MOTION PICTURE ASSOCIATION

Mr. THALHIMER. Senator Byrd, and gentlemen of the committee, we would like to file a written statement with the committee.

I would like to state, also, that we concur with Mr. Abram Myers' statement.

My remarks will be limited to, perhaps, 3 minutes.

Senator BYRD. Take what time you please.

Mr. THALHIMER. There are approximately 20,000 motion-picture theaters in the United States, and from the figures of 1949 they represent an investment of $2,700,000. The total investment in Hollywood in the production of movies represents less than $350,000,000.

These 20,000 theaters are owned in the vast majority by the citizens of the towns and cities in which they are located. They pay their full share of local and city taxes.

The company that I represent has paid to the Government in taxes which we have collected, admissions taxes, in the last 9 years, $4,246,000.

That represents an average over that period of time of about 30 theaters, all in Virginia.

It is very unpopular to say anything that would cast a reflection on churches or charities or metropolitan operas. However, if we are to continue as a free enterprise—I will not burden the committee with the terrific competition that these theaters have.

In Virginia, their business is down 28 percent from the 1945–49 figure of admissions. There have been closed in Virginia in the last 6 months over 25 theaters and it is anticipated that others will be closed.

Now, our objection in Virginia, gentlemen, is due entirely to the fact that the American public, after they pay their taxes and their rent and food and clothing, have a certain amount of dollars left over for amusement.

They have the free privilege of going to operas or symphony orchestras, rodeos or baseball games or anything they want. But if you exempt certain amusements from the payment of Federal admission taxes, you are definitely placing a great penalty on the amusement business that is not exempted.

I repeat what Mr. Myers said: It will encourage fly-by-night promotion, people who come to the town in the name of sweet charity to give the net admission receipts, and it is net after what? Not after the payment of salaries to these people, not after payment of rent to some landlord, and the small amount that they leave with this charity is out of all proportion to the large amount which they take away from the community.

I do not believe that Mr. Petrillo is going to reduce the wages of the musicians if the Government waives admission taxes for symphonies and metropolitan operas any more than labor would reduce the cost of its operators and union employees in theaters if you took the admission tax off the theaters.

You would simply create a condition that, in my opinion, would have a tendency toward bankrupting legitimate amusements, and in the final anlysis, without benefiting the orchestras, the operas, and the charities that think that they would be benefited; because, as I say, if the show is worth seeing they will go to see it, and if it is not worth seeing, they will not go to see it because of charity.

So the Virginia association appeals to this Finance Committee on the ground that it would be a discriminatory thing for you to do, that it would be an un-American and undemocratic thing to do, and it would be a great injustice to those people who have invested their life savings in various legitimate amusement enterprises.

They would be the ones who would be hurt.

Thank you very much.

Senator BYRD. Thank you very much.

Now, Mr. Thalhimer, I have two statements, one of Mr. Crockett and one of Mr. Barton.

Do you desire them inserted?

Mr. THALHIMER. I would like that inserted and the one by Mr. Barton on section 123.

Senator BYRD. Thank you very much, sir.

(The prepared statements of Robert T. Barton, Jr., and William Crockett, referred to, are as follows:)

STATEMENT OF WILLIAM F. CROCKETT, IN BEHALF OF THE VIRGINIA MOTION PICTURE THEATRE ASSOCIATION

My name is William F. Crockett. I am from Virginia Beach, Va., and I speak on behalf of the 240 members of the Virginia Motion Picture Theatre Association (of which association I am president), who are opposed to sections 123 and 402 of the pending tax bill.

Section 123 will increase the tax burden of the so-called control groups, which have developed not for the purpose of avoiding or evading taxes but for sound business reasons by between 100 and 200 percent. I am informed that the opposition to section 123 has been fully aired by many others very adversely affected by this measure. For that reason I will not elaborate our opposition but will file with the clerk of the committee a statement.

The remainder of my remarks will be devoted to our opposition to section 402 of the pending tax bill. The Virginia association opposes this proposal because the exempted activities are in direct competition with motion pictures which not only pay admission taxes but also pay many other taxes which make the exempted activities possible in considerable part. Furthermore, the exemptions will accomplish no good but will lead to many "promotions" in the name of "charity."

This is not the time to discuss the unfairness of the 20 percent admissions tax and the burden it imposes upon the motion-picture exhibitor who, in the final analysis, pays the tax because of its adverse effect on admissions. Let me state here that Virginia exhibitors stand ready and willing to bear their fair share of the tax burden but they do not like to be singled out to pay a tax akin to a luxury tax. Movies are a necessity, especially in these difficult times. The tax falls heaviest on those least able to pay it; the people whose principal source of amusement is the movies are the people in the lower-income tax group. We still live in the hope that when the emergency revenue needs of our country are met, you will repeal this discriminating tax. We repeat—we know from costly experience that admission taxes directly affect attendance. Entertainments which do not have to charge admission taxes have an advantage over entertainments that do have to collect admission taxes.

Let us analyze proposed section 402 and detail some our reasons for our opposition to this section.

Paragraph (c) excepts "any admissions all the proceeds of which inure" to certain organizations designated in subparagraphs (A), (B), and (C). We take it that the amount of the "proceeds" is something different from the amount of "admissions" and this is borne out by the fact that each of subparagraphs (A) and (B) concludes with the proviso: "if no part of the net earnings thereof inures to the benefit of any private stockholder or individual." This can only mean that the several organizations listed are exempted from the admission tax, if after paying all expenses including salaries and promotion fees, the organizations receive all of the "net earnings." We know from experience how clever promoters will go to charities and veterans' organizations (two of the exempted organizations) and promise all the "net earnings" if the organizations will permit the use of their names, and after the expenses and promoter's fees are deducted, the "net earnings" are extremely meager. The organizations have sold their names for a song—their birthright for a mess of pottage.

If people want to do something for such organizations, let them make direct contributions and secure the full benefit of tax deductions.

Some symphony orchestras, another exempted organization, masquerade under the guise of civic organizations, taking thousands of the tax amusement dollars from communities and after the promoters get their take, little, if anything is left as "net earnings." The well-to-do symphony audience is far better able to pay admission taxes than the lower-income-group movie goers.

Cooperative and community center moving-picture centers are in direct competition with commercial movies. The license and real-estate taxes paid by the commercial movies indirectly help to finance such organizations. If they are exempted from the admission tax and people can see the same movies at lower prices at the community movie house than at the commercial houses, they will not go to the commercial movies. What is going to happen to the latter? This measure will destroy the very source from which you expect to attain revenue.

Subparagraph (C) exempting entertainments for the benefit of police and fire departments, their members and the members' dependents and heirs, does not carry the "net earnings" phrase for some reason, although, obviously, such entertainments cannot be held without expense and the "proceeds" will not be the full amount of the "admissions." Here again the promoters will operate under the auspices of the fire and police departments and after getting their most generous take, will turn over to the organizations the "net proceeds" left over, if any.

While paragraph (2) excludes from the exemption "carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation," there are plenty of entertainments in the country which cannot be so classified and which now are giving exhibitions under the guise of sweet charity or for one or the other exempted organizations who will profit by these exemptions to the benefit of the promoters and at the expense of the commercial movies.

The difference in the cost of admission made by the tax makes a world of difference to the patron, especially the patron who wants to take his family. We know this from costly experience. If this were not true, we would not be here protesting the tax.

While elementary and secondary athletic contests are less liable to this sort of tax evasion, now that many of such contests are held at night, they take their share of the amusement dollar, compete directly with the movies, so if the movies are taxed, such contests should also be taxed.

Subsection (D) exempts publicly operated swimming pools, bathing beaches, skating rinks, and other places for physical exercise "if the proceeds therefrom inure exclusively to the benefit" of the governmental instrumentality operating the facility. Here again "proceeds" must mean something less than the total "admissions" because these facilities cannot be operated without expense. Often they are leased by the governmental instrumentality so the proceeds are the rentals. The lessee-promoter makes a substantial profit and uses the Government instrumentality to avoid collecting an admission tax, although he is in direct competition with commercially operated entertainments, which have to collect admission taxes.

We trust we have made it clear that not only do the proposed exemptions further discriminate against the movies but they also open wide the door for tax evasion and avoidance. We speak from bitter experience.

The exempted organizations have gotten on pretty well since 1941 when many of the now proposed exemptions were removed from the tax law. Why now reinstate these exemptions? Increased legitimate competition is now giving the movies a battle for their lives; why add to their difficulties?

If it is fair to tax most people for their amusement, it would be unfair and un-American to make the exemptions as called for in section 402.

As long as the amusement taxes are needed for the defense effort, we sincerely believe there should be no exemptions and that section 402 should be stricken from the bill in its entirety.

STATEMENT OF ROBERT T. BARTON, JR.

My name is Robert T. Barton, Jr., and I am counsel for the Virginia Motion Picture Theater Association which is opposed to the provisions of section 123 of the proposed tax measure; this is the section which limits the surtax exemption and the excess-profits credit of a so-called controlled group of corporations.

The Virginia Motion Picture Theater Association is an organization of substantially all of the motion picture theater owners and operators in Virginia. The association opposes this section for the following reasons:

For sound, practical business reasons the motion-picture business is conducted by corporations. The motion-picture pioneers, in order to limit the risk of venture capital and the risks of catastrophe, because theaters in the earlier days were not as safe as now, opened and operated motion-picture houses as separate corporate entities. For the same sound business reasons and since one cannot always be certain that a motion-picture house in any one location or in any one town, or city will be or continue to be a success, separate theaters are usually operated by separate corporations. Sometimes, and for the same reasons, two or three theaters may be grouped under one corporation. A successful theater today due to competition, may be a failure tomorrow. I doubt if the tax angle was often considered when these corporations were organized, because the capital risked had first to be turned into a profitable venture before any tax questions arose.

A lot of people have gone into the motion-picture business thinking that all one had to do to make a fortune was to build or lease a theater, exhibit films, and take in the money. Some succeeded; others failed and desired to sell out or turn their operations over to the more successful exhibitors, often on a percentage-of-earnings lease basis. The more successful exhibitors took over the corporations of the sellers or organized new corporations to take over because if one exhibitor had made a failure, there was no reason to be sure that the successor would make a success of the business and the successor did not want his other business tied into the new venture in the event it failed. Some successful operators wearied of the business, became sick, grew old, or died and so their operations came on the market and were acquired by other operators often through the purchase of the outstanding stock in the operating corporations.

It is on this situation, brought about, not to avoid taxes, but to protect venture capital, that this proposed tax will unjustly fall, increasing the tax burden in many instances over 100 percent.

Theaters are now paying a 20-percent amusement tax, a tax not paid by ordinary commercial enterprises. There has been no increase in the price of admissions comparable to the increase in everything else, in spite of the fact that movies' expenses have greatly increased; and movie attendance is down at least 20 percent from the high of 1946 and on this unhappy situation would be imposed another inequitable tax.

Not only is the tax unjust and unfair to these corporations but it also will discourage further venture capital. I may be willing to risk my money in a project if I am sure that should it fail, I will only lose my investment, but I am unwilling to venture part of my capital, if the rest of my capital may be involved in the failure. If, on the other hand, I am going to be penalized taxwise in the event the venture is a success, because I own all the stock of the new corporation and of other corporations where I have successfully ventured capital, I am not going into new enterprises.

Enough has been done already taxwise and otherwise to discourage free enterprise and the taking of business risks. I urge you not to do more by enacting section 123 into law.

Senator BYRD. In lieu of appearance, the Chair will insert in the record a brief by Morris A. Schapiro in respect to certain sections.

(The document referred to follows:)

HOW COMMERCIAL BANKS ARE AFFECTED BY FEDERAL TAXATION

(Statement of Morris A. Schapiro, M. A. Schapiro & Co., Inc.)

To help banks in their need for new capital, certain penalty features in existing tax laws require correction.

Normal or nonexcessive earnings of 6 percent (i. e. before excess profits tax but after regular corporate taxes, now at 47 percent) require a definition of 12 percent on all invested capital, not on just the first $5 million.

Further, to encourage the flow of new capital, banks should be permitted to hold without penalty tax-exempt securities in an amount equal to their total invested capital, including of course any new capital. Only those holdings in excess of this amount should be made cause for reduction of the invested capital credit.

Taxing authorities should examine and remove inequities and technical difficulties, particularly those which prevent banks from using the average-earnings method.

In this way alone, will the case for bank capital be strengthened in the eyes of investors, and banks once again have access to the capital they need.

INEQUITIES BLOCK ACCESS TO NEW CAPITAL

Commercial banks are essential to our dynamic economy. They give efficient service at low cost to individuals, to business, and to Government. As a result of the inflationary trend of our times, banks have experienced an unprecedented growth of deposit liabilities and risk assets. Thus, in 1950 loans of insured banks expanded $11.0 billion or nearly 22 percent. At the end of 1950, their total loans had reached $51.6 billion, an expansion of $31.2 billion or 102 percent in 5 years. These changes in the banking scene increase the importance of capital for all commercial banks.

These banks are subject to the same Federal income tax laws as other privately owned corporate enterprises. In banks, however, compared with other businesses, the rate of return on capital after taxes is low. Because of this low return, investors are not attracted to banking, and banks, therefore, are finding new capital difficult to obtain.

Federal taxation denies investors fair hire for the very money which enables commercial banks to operate as private enterprises. The withdrawal of existing capital is actually place, as evidenced by the increasing number of bank mergers throughout the country. Tax laws allow little incentive for shareholders to approve proposals for additional capital, now of increasing importance to banks serving an expanding economy.

The adverse effect of Federal taxation bears heaviest today on those banks in greatest need of capital. These are banks whose growth in loans and deposits has been greater than average. Country banks and city banks alike, they are the banks which have developed the broadest contact with the public, merchandising their services most effectively and generally providing a retail type of operation. "Brown derby banks," they serve individuals and small businesses as well as larger customers. Expanding business has placed them in this need of new capital, and their problems, therefore, are of concern to bank managements as well as Government banking authorities.

Federal taxation blocks many large and small banks from access to new capital and seriously handicaps others. Nevertheless, State and Federal banking authorities, alert to the shrinking capital ratios resulting from the increased deposits and loans of today, are properly recommending additional capital for many banks. The problem centers in the same market place where prime bank shares of unquestioned asset value still continue to sell at discounts from book values. The dominant reason for "banks at a discount" has been, and is today, their low earning power.

TAXES FORCE THE DISCOUNT

True, expanded business of the banks has increased their gross income. But salaries, wages, and related benefits are higher. There are pension costs. The total of interest paid, rents, supplies, and other expenses are up. Exclusive of State and Federal income taxes, operating costs of all insured commercial banks in 1951 are expected to be 73 percent above 1945.

In competition for deposits and loans, banks have had little to say over the price of their services. Since 1945, they maintained their income by doing more business each year. Banks steadily increased their risk assets, but also reduced their liquidity. Most of the added income merely overcame the added costs.

Now with the full impact of Federal taxation, the rate of earnings on stockholders' money is unfairly low despite the expanded services and risk assets which the banks have had to assume. It is a case, as the Red Queen remarked to Alice, of "taking all the running you can do to keep in the same place." But from these low and hard-won earnings, one must deduct the losses which the future alone will disclose. When these are known, the extent to which banks are now living on their capital will then be told.

Banks have not been as successful as industry in passing on to their customers the rising costs which all have experienced. Under these circumstances, taxes force the discount on stockholders' money, thereby penalizing all stockholders.

NEW CAPITAL UNPROFITABLE

New financing can only be effected at or below these depressed quotations. To obtain additional capital, banks are compelled to accept less than fair value for their shares, and then the pro-rata rights to subscribe at these low prices are traded in pennies, if not quoted as worthless. Current and prospective earnings, not asset values, create this difficulty.

Recently, in the case of a nationally prominent bank where additional shares were offered to stockholders, the price was set at 70 percent of book value. To the extent that stockholders were unable or unwilling to take up their subscription rights, new partners were taken in through the sale of shares at a discount from book value. In addition to sacrificing part of their equity, the old shareholders found their earnings diluted.

To attract new stockholders, the cash dividend return or yield for these new partners was nearly 5 percent, whereas the rate received by old stockholders on their book value had been less than 4 percent. This was clearly a penalty, a general acknowledgment that bank earnings are too small. In other bank financings, old stockholders were penalized even further. Moreover, in many banks they will soon discover that Federal tax laws prevent this new capital from earning its dividend requirement and that they will, in effect, be making good the dividend on the newly issued shares.

Stockholders who approve proposals for capital increases do so believing that the future of their banks and the needs of the community are being served by this strengthening of capital. But the limitations of present Federal income and excess profits tax laws on earnings make these proposals unprofitable. They are only now becoming alerted to this costly situation. Government taxing authorities must recognize bank capital as worthy of its hire, if demands of the banking authorities for stronger capital structures are to be met. New financing to meet these demands will have to wait for favorable conditions.

BANKS IN CRITICAL IMPASSE

Banks seek capital to keep pace with expanding business. The importance of this new capital is recognized. Bank capital functions in the public interest because it is a guaranty fund protecting the people's deposits against impairment. By making loans to individuals and business possible, bank capital keeps commerce free and flowing. Bank capital needs every encouragement and safeguard to assure its sound and steady growth.

To attract and retain capital, banks must have adequate earning power on their stockholders' investment. This they do not now have. If they did, their shares would not be quoted at less than book value. The effect of Federal taxation is penalizing. Low earning power continues "banks at a discount." This discount which the market places on stockholders' money makes proposals for new capital costly, and often prohibitive, and creates a critical impasse for banks.

Federal tax laws define excess profits. Banks are paying taxes on their excess profits. The question is asked, How can banks have excess profits when their shares are quoted at heavy discounts? The answer is, banks do not have profits which are excessive, and the excess-profits taxes they are compelled to pay keep them at this discount. This is true.

First, because of their low earnings on book values, bank shares were quoted at discounts in the years prior to the excess-profits-tax law of 1950. Poor base period average earnings and technical inequities place banks at a basic disadvantage in comparison with other industries. Banks generally did not have high "average earnings" for their base-period years as did industrial and manufacturing corporations. Most banks must therefore use the alternative invested-capital method in computing their exemption from excess-profits taxes. Under this method corporate earnings are defined "excessive" when they exceed certain rates on invested capital. The basic exemption from excess-profits taxes for banks, unlike most industrial corporations using average earnings, is small in relation to book value or invested capital. Hence bank stocks continue at their discount from book value.

Second, normal or nonexcessive bank earnings, which are not subject to excess-profits taxes, are subject to combined normal and surtaxes of 47 percent. Such normal or nonexcessive earnings as defined by the tax laws are calculated before taxes. But in the eyes of investors, and in the market place, meaning is given only to what is left of normal earnings after taxes. The rates allowed on invested capital of 12, 10, and 8 percent appear adequate, but after regular taxes of 47 percent, the net of 6, 5, and 4 percent is no longer adequate. This earning rate of 4 percent is too low to hold capital, let alone attract new investors. Investors making comparisons with the regulated public utilities, know that public service commissions have always recognized 5½ percent after taxes, and often 6 percent and more, as a fair return on capital.

Third, in the case of large banks with capital in excess of $10 million, this 4 percent rate means that the law establishes in principle a normal return fixed under Federal enactment of not more than $4 of recurring earnings per $100 of book value. This low return for banking capital would have to be appraised in the investment market at 25 times to support quotations equal to book value, a valuation admittedly out of line and unreal in the market for equities. Hence, the discount on stockholders' money.

The so-called excess profits of banks—the amount over and above these low normal earnings—are in effect taxed at a rate of 77 percent, the total of normal and surtaxes of 47 percent and excess-profits taxes of 30 percent. It is a serious question indeed whether shareholders, understanding this impact of Federal taxes, would want their banks to assume banking risks while subject to this 77 percent rate.

The ability of commercial banks to grow with the expanding needs of industry and to furnish the essential services demanded by a defense economy is therefore retarded. Already, State and Federal banking authorities are concerned with the level of risk assets, high in relation to existing capital. Except for the few who would want all credit functions taken over by the Government, the implications of this difficult situation are serious and demand a realistic approach to bank earnings.

SMALL INVESTOR SUFFERS

The present exemption allowed of 12 percent on the first $5 million, 10 percent on the second $5 million and 8 percent on additional invested capital is a penalty on the larger banks. But these are the banks with widely distributed ownership. Therefore, these penalty rates on large banks hurt the small investor.

The question has been asked, To what extent does the 8 percent rate on invested capital apply? The 8 percent rate applies to banks with invested capital in excess of $10 million. These are the banks which hold half of the $11.3 billion capital and half of the $163.5 billion deposits of the 13,446 insured commercial banks. Including banks with invested capital of between $5 million to $10 million, the penalty rates of 10 percent and 8 percent, before regular income taxes, affect the major part of the banking assets throughout the country, and hurt the great majority of bank shareholders everywhere.

MINIMUM WAGE FOR CAPITAL

The proposal to increase the regular corporate tax rate from 47 to 52 percent would cut investment returns even further. This makes a realistic definition of "excess profits" more pressing, since the rates allowed of 12, 10, and 8 percent on invested capital lose meaning with each increase in regular taxes. To be realistic, a definition of "excess profits" must allow investors incentive to continue as shareholders and to approve proposals for capital increases. The investor will not accept too low a figure; the source of new funds will dry up.

If fair hire for bank capital is taken to mean cash dividends at the rate of 4 percent of principal, or book value, then the recurring earning power of banks after taxes should be protected at not less than 6 percent of book value. To secure a net of 6 percent after regular corporate taxes, now at 47 percent, normal or nonexcessive earnings should be defined at 12 percent of all invested capital. This is the minimum required to relieve the critical impasse now facing banks.

Provisions affecting bank holdings of wholly and partially exempt investment securities, described by existing tax law as "inadmissible" assets, are basically necessary. However, the present limitations should be reconsidered and changed to correct obvious inequities. To relate such holdings to amounts held on January 1, 1950 imposes an unjustifiable hardship on a great many of the 13,446 insured commercial banks, all of which are now operating under radically changed conditions. To encourage the flow of new capital, it is only fair that these new funds be made free for investment in tax-exempt securities without reducing the invested capital credit used to determine normal or nonexcessive earnings. Further, banks should be permitted to hold without penalty "inadmissibles" in amount equal to their invested capital. Only holdings in excess of this amount should be cause for appropriate reduction of the invested capital credit.

RESERVES MUST BE EARNED

Earning power, the source of cash dividends, means net current operating earnings—the result of day-to-day bread and butter items of operating income, less operating expenses, less applicable State and Federal income taxes. It does not mean profits or losses on sale of securities, charge-offs or recoveries on loans, transfers to reserves, or other capital transactions, or the tax credits or tax liabilities to which these sometimes give rise.

Banks must retain a portion of their recurring earnings, first, to create reserves for losses, thereby protecting their present capital from erosion, and second, to add to their capital funds—necessary because of the tremendous growth in their deposit liabilities and risk assets.

It should be remembered that earning power of 6 percent net after taxes is calculated before provision for losses. Banks differ from public utilities. At the year end, the results for an electric power company are known, but in the case of a bank, only interest income, fees and expenses are known. The losses are unknown. In banks, the returns do not come in together. It is basic to banking that provision for losses be made out of sufficiently adequate current earnings, not out of existing capital funds. Therefore, in defining normal earnings not subject to excess-profits taxes, it should be possible for banks to set aside out of recurring earnings the added cushion for losses. Hence, earning power at 6 percent is not enough for banks in good times when the risk factor is in the ascendance.

TAXES PENALIZE GROWTH

This is particularly applicable to undercapitalized banks where a higher rate of earnings is essential, first to provide adequately for losses; and second, to justify and support additional capital. But the adverse effect of excess-profits taxes is heaviest on those banks which are in the greatest need of capital. Growing banks where invested capital is small in relation to deposit liabilities and risk assets exceed the statutory limits of "non-excessive" earnings—12, 10, and 8 percent of invested capital—sooner than banks where there are no capital problems. Undercapitalized banks are now paying excess-profits taxes while heavily capitalized banks are not. Thus, excess-profits taxes deny undercapitalized banks the earning power required to build up their capital through retention of recurring earnings after payment of cash dividends, or through sale of additional shares on a basis equitable to both old and new stockholders.

The proposal to raise the regular corporate tax rate from 47 to 52 percent means that the effective rate of earnings, before excess-profits taxes, on invested capital in excess of $10 million would be less than 4 percent after regular taxes. This acts to depress bank shares even further and to widen the discount at which they have been quoted. Federal taxation is a factor prompting the withdrawal of private capital from commercial banking—a development which can be seen in the increasing number of bank mergers throughout the country.

Shareholders find merger proposals irresistable. This is quite understandable. During these years of great prosperity and high level of financial activity, shareholders see their banks with record totals of loans and deposits. They note the progressively higher interest rates on loans and securities. Stockholders are unable to reconcile these evidences of prosperity with their banks at a discount. As one investor observed, "For 18 years, banks have been quoted at a discount. During most of these years, there was not enough business to make banking profitable. Now banks have plenty of business, but Federal taxes cancel out this prosperity."

If independent banks are to continue, they must be profitable to shareholders. All bank managements throughout the country have the obligation to state their shareholders' case to our taxing authorities. Present conditions are no recommendation to private capital for investment in banks. If access to new capital remains blocked, and withdrawal of existing capital continues, how can eventual recourse to public funds to take the place of private bank capital be avoided?

Senator BYRD. In lieu of appearance, the Chair will insert into the record a memorandum submitted by the Mid-Continent Oil and Gas Association, Independent Petroleum Association of America, the Western Oil and Gas Association, American Petroleum Institute and Rocky Mountain Oil and Gas Association.

(The document referred to follows:)

MEMORANDUM SUBMITTED BY MID-CONTINENT OIL AND GAS ASSOCIATION, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA, WESTERN OIL AND GAS ASSOCIATION, AMERICAN PETROLEUM INSTITUTE AND ROCKY MOUNTAIN OIL AND GAS ASSOCIATION

The Internal Revenue Code provides for withholding of tax at the source on wages, income payments to nonresident aliens, and interest on tax-free covenant bonds. Section 201 of House bill 4473 provides for extension of the withholding requirement to include 20 percent of all payments of dividends, interest, and royalties. The term "royalty" is defined in the proposed law to include "any rent or royalty in respect of mines, oil and gas wells, and other natural deposits, including any delay rental and any minimum royalty, whether or not measured by production or by a share of gross or net income therefrom, and any payment representing a share of the gross or net income derived from the extraction and sale of any natural deposit, but only if the recipient of such rent, royalty, or payment is not personally obligated to pay a proportionate share of development or operating expenses."

This all-inclusive definition of royalties would require withholding on a substantial portion of the payments made by oil and gas purchasers and producers. In addition to true royalties, oil producers would be required to withhold on many payments which are not royalties at all, such as: delay rentals, payments under net-profit contracts, carried-interest contracts, in-oil-payment contracts, and overriding royalties, all of which are payable out of the working interest as distinguished from the true royalty interest.

This proposed amendment to the revenue code would result in an expense to oil and gas purchasers and producers and to the Government greatly exceeding the additional revenue which it is estimated will be collected and retained therefrom. It would impose unjust, discriminatory, and otherwise unconstitutional penalties on producers unequaled in the history of the income-tax laws. Many of the practices and procedures of oil and gas producers and most of their deeds, instruments, and other forms would have to be completely revised if the proposed withholding provision is adopted. The status of many valuable properties and the relationships of producer, landowner, lease broker, and other interested parties involved in oil and gas production would be rendered uncertain.

DELAY RENTALS

It seems evident that those who proposed that the withholding provisions of the House bill be extended to delay rentals were not fully aware of the significance of such a proposal. It must be assumed that they did not know that the requirement could result in the unconstitutional taking of the property of the withholding agent.

Practically all oil and gas leases today provide that the lease shall terminate on a specified date, unless on or before said date the lessee shall pay to the lessor or deposit to lessor's credit in the depository named a stated amount of money (usually called a delay rental) which shall defer for a designated period the necessity of commencing drilling operations. Payment of delay rental as stipulated is a condition upon which the continuation of the lease depends and thereby it differs distinctly from the customary rental payment. The lessor has no right of action in court to sue for delay rental payment because nonpayment results in the termination of the lease. The courts have held that failure to pay the full amount of the rental on or before the rental payment date at the place designated in the lease and to the payee therein designated terminates the lease. When once terminated, the lease cannot be revived. The courts have even held that the lease terminates through the failure of the payee to receive the delay rental was due to no fault or failure on the part of the person obligated to pay the delay rentals. Legislation which would undertake to change the lease contract by requiring the lessee to pay any part of the delay rental to a person other than the one named in the lease could constitute an impairment of the obligation of the contract.

Obviously, if the withholding provisions of the proposed bill are enacted, the lessee will be seriously penalized. If lessees withhold the tax and pay 80 percent of the rentals provided for in the leases, it may be urged by the lessors that lessees have failed to comply with the plain provisions of the leases, and lessors may insist that the leases are terminated. If they fail to withhold the tax, lessees will incur the penalties imposed upon them for a willful disregard of the withholding provisions of the tax law. In order to insure validity of their leases and at the same time to avoid the tax penalties for willful failure to withhold tax, the lessees, as an alternative, may be forced into the position of paying their lessors the full amount of the rentals called for in their leases, and paying out of their own pockets the amount of withholding called for by the statute. This would necessitate payment of rentals approximating 125 percent of those called for in the lease contracts. No other withholding agent is subjected to such an unjust and discriminatory burden upon penalty of possible forfeiture of his property for failure to assume such burden. For example, in the case of a lease calling for a delay rental of $100, the lessee would have to pay $100 to the lessor and then pay the Government $25 (which would represent a 20-percent withholding on the total payment of $125). It is respectfully submitted that the withholding provisions of the proposed bill, if applied to delay rental payments, may result in the taking of the property of the lessee without due process of law, which is clearly in violation of the protection afforded by the Constitution.

Even if Congress could by some device remove the penalties above noted, it is submitted that the administrative burden which would ensue from withholding of tax as to delay rentals is disproportionately high in the light of the small amount of tax revenue, if any, which the Government would ultimately derive.

To comply with the act and to avoid this penalty on leases executed in the future would require the industry to scrap all present lease forms and set up a completely new procedure of leasing, thereby incurring a tremendous amount of administrative costs. The hundreds of thousands of existing leases could not be changed except by mutual consent of each party.

One of the principal administrative objections to withholding with respect to delay rental payments arises from the circumstances under which leases are ordinarily acquired. Oil and gas leases are usually obtained without any previous title examination of the property and the party negotiating for the lease attempts to procure execution by every person who is believed to have any interest in the property. As a result, approximately 85 percent of the leases obtained provide for payments to multiple payees. Because of these circumstances, the oil and gas lessee does not know the amount of the payment to which each of the multiple payees is entitled. Furthermore, the delay rental payments are more often than not paid to a depository bank for the account of the multiple payees and the bank holds the rental payments until the various payees either agree among themselves as to the proper division or by proper court proceedings establish their respective rights. The oil operator paying the delay rental to a depository bank has no way of ascertaining the address of the several payees or of insuring delivery of the anual withholding receipt called for in H. R. 4473 to the proper persons.

LEASE BONUSES

Bonus payments in the case of oil and gas leases are usually one-time payments. Ordinarily the lease is either developed for oil and gas or it is surrendered and no subsequent bonus payments are made. Bonus payments, therefore, are not regular and recurring and should not be the subject of withohlding. Most oil producers extensively use the services of independent lease brokers in securing oil and gas leases. In some instances these brokers purchase as agents for the producer. In many other instances, the brokers assemble blocks of leases for their own account and subsequently resell these leases at a profit to oil producers. Frequently an assembled block of acreage consists of leases acquired by the broker both as principal and agent. In such cases it is impossible to determine at the time payment is made what portion of the payment represents bonus subject to withholding and what portion is consideration for the leases owned by the broker, no part of which would be subject to withholding. Most leases are forwarded from the field accompanied by a bank draft. At the time of payment of the draft it is impossible for the producer to determine what portion represents broker's commission, broker's selling price, or landowner's bonus, if any.

Since oil and gas leases are ordinarily obtained without title examination, the person taking the lease does not have actual knowledge of the ownership of the property at the time the lease is taken. Consequently, an attempt is made to obtain the signature of all persons who may possibly have any interest in the lease and the bonus payment is made to the individuals jointly. In many cases corporations (exempt from withholding) are parties to the lease along with individuals. Since the division of interest is not known and since corporations are frequently involved as lessors, the lease broker or oil company, as the case may be, has no knowledge at the time the bonus payment is paid what portion of the payment is subject to withholding, if any, or the amount payable to any particular lessor.

The education of landowners to withholding will be virtually impossible in many areas. Farmers and other landowners will insist on a bonus price after taxes which will conform generally to bonuses previously paid in their areas. As a consequence, the tax will, in most cases, have to be absorbed by the oil producer, thus materially increasing the direct costs of acquiring oil and gas leases.

ADMINISTRATIVE DIFFICULTIES—OIL INDUSTRY

The current proposal of the House Ways and Means Committee directly conflicts with the explanation given by the Senate Finance Committee for rejecting the 1950 proposal to collect income tax at source on dividends because "it would increase unduly the work of the withholding agents." The problems relating to the withholding from royalties, bonuses, delay rentals, and production payments far surpass those which would have been encountered in withholding from dividends as proposed in the 1950 bill.

The oil and gas industry through experience has developed contractual relationships and methods of doing business unlike those of any other industry. The proposed withholding provisions would require radical and costly changes in these proven operating practices.

The requirement to withhold on royalties would discriminate against the extractive industries because in no other instance is withholding required on the gross proceeds received from the sale of property or on the payment of rents. A substantial portion of the records and forms used by the industry would be rendered obsolete. New records and forms would have to be designed and printed to account for the tax withheld.

It would be necessary for the withholding agents to ascertain whether any of the interest owners are corporations, because payments to corporations would be exempt from withholding. The withholding agent would also be required to ascertain whether individual owners of each separate interest are personally obligated to pay a share of the operating expenses. This information cannot be secured without correspondence with hundreds of thousands of interest owners, particularly in the case of withholding by oil or gas purchasers who have no interest in the producing property.

A very substantial number of the payments for oil and gas royalties are made to banks as trustees for several beneficiaries or jointly to more than one person. In most of these cases it would be impossible for the withholding agent to furnish the Treasury Department with a report showing the amount paid to each person or to furnish each individual beneficiary a receipt for taxes withheld as provided in the bill.

The bill would require the withholding of tax and remittance to the Government for royalty payments where the payee is unknown. Royalty payments are always held in suspense pending determination of the legal interest owners. To withhold and pay tax to the Government under such circumstances would result in confusion in that withholding statements could not show the royalty owners' names. In many instances the income would not be properly reportable in the current year by royalty owners. Consequently, the annual withholding statements supplied by payors could not be matched up with the returns filed for the year of withholding. Furthermore, in such instances the tax would be erroneously withheld from corporations, working interest owners, and so forth.

The present practice of the oil or gas producer or purchaser is to deduct the entire amount of State severance tax and other proper charges from the value of all of the production from a particular lease. Thereafter the distribution between the royalty owner and the working-interest owner is made on the basis of the net value of the production after the deductions mentioned above. H. R. 4473 would require the withholding to be based upon the gross value of the royalty owner's share of production. Such a requirement will impose upon the oil producer or purchaser the added administrative burden of calculating the royalty owner's share of the gross value of the production, although the payment has been made upon the net value of such production. The calculation of withholding on the basis of gross value as compared with net value would impose a very substantial additional administrative cost upon the withholding agent.

It will not be possible, except by costly manual methods, for oil producers to comply with the withholding requirements unless additional accounting machines and equipment can be secured before the effective date of the act. Currently, required machines and equipment cannot be secured in less than 18 months to 2 years because of the very heavy demands of the Federal Government and restrictions on material.

The oil industry has a vital responsibility to provide an abundant supply of oil both for peace and wartime needs. Its efforts and manpower should be concentrated on this goal and not diverted by forced changes in industry practices and procedures.

ADMINISTRATIVE DIFFICULTIES—TREASURY DEPARTMENT

It is logical to assume that the Treasury Department would be saddled with the burden of making a much larger number of refunds and with other administrative details involved in giving taxpayers proper credit for amounts withheld in excess of their liability. The additional number of refunds to be made could run into the millions. Additional work would be placed on the Treasury Department in connection with suspense accounts that would have to be maintained by the Government for taxes required to be withheld and remitted to the Government before the payee is ascertained. In such situations, the tax withheld will be remitted to the Government in one year, whereas the royalty income is properly included in taxable income of the payee in another year. The Treasury Department would also be burdened with the task of auditing and matching the records and reports of withholding agents and payees. Certainly the Treasury Department's administrative job will not be simplified by withholding income taxes from royalties, delay rentals, lease bonuses, and production payments.

NET LOSS TO THE GOVERNMENT

The House Ways and Means Committee report states: "It is estimated that for the calendar year 1951 underreporting may amount to as much as $1.1 billion in the case of dividends, $1.9 billion in the case of interest, and $40 million in the case of royalties." This estimated underreporting totals $3,040 million. In table 12, appearing on page 62 of the report, it is estimated that adoption of withholding on dividends, interest, and royalties would increase the Government's revenues by $323 million, or 100 percent of such income unreported. Based on these estimates of the committee, approximately $4,240,000 is the maximum additional tax that could be realized through withholding on the $40,000,000 of underreported royalties, which includes an unspecified amount of unreported royalties on patents, copyrights, et cetera. The most recent Minerals Yearbook released by the United States Department of the Interior indicates that oil and gas accounts for only 44 percent of the total dollar value of minerals produced in the United States. It would thus appear that only 44 percent of that part of the $4,240,000 which represents the additional tax to be recovered by withholding on royalties other than on patents and copyrights would be recovered from withholding on oil and gas. This amount would conceivably not exceed $1,000,000.

The tremendous cost to the producers of oil and gas of withholding on delay rentals, bonuses, royalties, and production payments has been pointed out above. The increased cost of personnel and equipment, the larger lease bonus payments, as well as the penalty payments under delay rental clauses, would all constitute deductions for the oil and gas producers in computing their taxable net income. Since, most of the expenses will be incurred by corporations subject to taxes at rates ranging from 52 to 82 percent under the new bill, net tax revenues will be reduced rather than increased.

The cost to the Government of administering the proposed withholding on delay rentals, bonuses, royalties, and production payments would be greatly disproportionate to the additional tax which it has been stated will be recovered from this source. Since recipients of both royalties and bonuses will make various deductions authorized by law in arriving at their tax liability for the year, a very large percentage of them will be entitled to a refund. The Government would have the cost of processing these claims for refund, in addition to the cost of processing an estimated 3,000,000 withholding statements on delay rentals, bonuses, royalties, and production payments which must be identified with the tax returns of the recipients. Also, the withholding records of both the producers and the income recipients must be audited by revenue agents.

CONSTITUTIONAL QUESTIONS

There is a serious question whether Congress has the constitutional power to require the withholding of income tax on royalty payments. The sixteenth amendment gives Congress the power to levy taxes on income. It does not give Congress the power to levy any tax, even for a temporary period, on capital. Oil, gas, and mineral royalties differ vastly from dividends and interest. Dividends and interest are inherently income and could be paid indefinitely without impairing the capital out of which they grow. Such is not the case where royalties are concerned. The capital out of which royalty payments grow is represented by the total number of barrels of oil, cubic feet of gas, or tons of ore under the mineral property. Consequently, every barrel of oil, cubic foot of gas, or ton of ore produced for the royalty's owner account represents a return to him of a part of his capital. The value of the royalty owner's share of production is never income subject to tax in its entirety. Where the royalty owner's capital investment is small the portion of his share of the production constituting income may be relatively high, and where his capital investment is large the income portion will be low. Occasionally his cost is so high that it exceeds the entire value of his share of production so that he will never recover his capital through the royalty payments. Under the existing law the royalty owner calculates the portion of his rolayties representing a return of capital and the portion representing income and in his annual return reports, as being subject to tax, the income portion of his receipts from royalties. Under the proposed bill the entire royalty will be regarded as constituting income and income tax at 20 percent will be withheld at the time the royalty is paid. Accordingly, it is evident that by withholding the Government will be levying a tax on the portion of the royalty which is not income at all but is truly a return of the royalty owner's capital. In this connection withholding cannot be justified on the ground that the royalty owner can seek a refund or credit for the portion of the tax withheld on capital because the sixteenth amendment did not give Congress any power to levy a tax on capital for any period of time.

Furthermore, royalties as defined in H. R. 4478 include payments reflecting a share of the gross or net income derived from the extraction and sale of any natural deposit. The income-tax law has always provided that the tax is imposed upon net income, that is to say, where goods are sold the vendor is always entitled to deduct and treat as a return of his capital the cost of the goods and he is also entitled to deduct the expenses incurred in connection with the sale. In other words, the income tax is not imposed upon the gross receipts from the sale of goods. H. R. 4478 clearly discloses that the withholding will be based upon the gross receipts from the sale of natural resources sold by or on behalf of the owner. Congress has no more constitutional power to tax the capital represented by the cost of oil, gas, or other natural resources sold than it would have to tax the capital represented by the cost of shoes, cattle, or gumdrops sold.

The requirement that withholding be based upon the gross value of the natural resource extracted and sold raises the additional question of the right of Congress to levy an income tax upon that portion of gross value which the royalty owner cannot possibly receive. Almost every State in which oil or gas is produced, and many States in which other minerals are produced levy a special tax (usually called a gross production or severance tax) which attaches to the mineral on severance and must be paid before any distribution is made to the royalty owner. The withholding of income tax at the source upon that portion of the royalty owner's gross proceeds which are collected on behalf of the State before any amount is distributed to him would represent an attempt to tax him upon his expense as well as upon his income. It is submitted that the sixteenth amendment conferred no such power on Congress.

If withholding is required with respect to delay rentals, the effect may be to impose upon the withholding agent the penalty of either forfeiting his lease or paying an additional rental equal to the tax withheld. Either of these penalties would constitute the taking of lessee's property without due process of law.

It is inevitable that the constitutionality of the withholding provision with respect to royalties, bonuses, delay rentals, and production payments would be contested in the courts. The confusion which would result while such litigation was pending would completely disrupt the oil and gas industry. Title to mineral leases would be so uncertain oil producers would hesitate to drill; the status of valuable producing properties would be subject to extended litigation; tax refunds would be claimed by hundreds of thousands of owners of mineral interests. The experience of the Government and taxpayers more than a decade ago after the Agricultural Adjustment Act was declared invalid suggests a few of the problems that would be encountered if the proposed withholding of tax on royalties should be adopted and subsequently declared unconstitutional.

Senator BYRD. Our next witness is Mr. Dodds.

STATEMENT OF BLIGH A. DODDS, CHAIRMAN, GOVERNMENT RELATIONS COMMITTEE, INTERNATIONAL ASSOCIATION OF FAIRS AND EXPOSITIONS

Mr. DODDS. Mr. Chairman, Senator Byrd, and members of the committee, my name is Bligh A. Dodds, of Gouverneur, N. Y.

I am chairman of the Government relations committee and past president of the Internal Association of Fairs and Expositions; also past president of the New York State Association of Agricultural Fairs, and a former director of the New York State Fair, Syracuse, N. Y.

I am presently secretary-manager of the combined operation of two successful St. Lawrence County fairs at Gouverneur, N. Y.

Senator KERR. I did not understand that last statement.

Mr. DODDS. Presently secretary and manager of the combined operation of two successful St. Lawrence County Fairs at Gouverneur, N. Y.

Senator KERR. Thank you.

Mr. DODDS. Mr. J. S. Dorton, manager of the North Carolina State Fair, at Raleigh, N. C., who is now president of the International Association of Fairs and Expositions, and Mr. Frank Kingman, Brockton, Mass., secretary-treasurer of this association, are in complete accord and fully endorse the statement which is here submitted.

We represent, Senator, the 2,500 agricultural fairs in the United States.

We greatly appreciate the approval in 1947 and again in 1950 by the Ways and Means Committee of the House of Representatives, and the subsequent approval by the House, of a bill in those years to do the very thing that we are seeking at this time; although there is much more factual information to present in behalf of our case, yet we have full confidence that your attitude will be a kindly one, and that if consistent with the Nation's best interests, you will decide favorably on our request which is here submitted.

In behalf of our association, and those gentlemen whom I have mentioned, I feel that is is not necessary to take more of your time. Our record is clear. It is in the hearing of the House Ways and Means Committee in 1947 and 1950, and if I may ask that the testimony which I have prepared be included in the official record——

Senator BYRD. That will be done, sir.

Mr. DODDS. I will desist from taking more of your time, except to mention that I also represent the New York State Association of Agricultural Fairs and that I have a very short brief in their behalf which I would also like included in the record.

Senator BYRD. That will be inserted in the record.

Mr. DODDS. We greatly appreciate the opportunity in speaking on behalf of Dr. Dorton and Mr. Kingman, to appear before this committee and for the generosity of your consideration in appearing here this morning.

Thank you very much.

Senator BYRD. We are glad to have you, Mr. Dodds.

(The statements previously referred to follow:)

STATEMENT OF BLIGH A. DODDS, GOUVERNEUR, N. Y., CHAIRMAN OF THE GOVERNMENT RELATIONS COMMITTEE, INTERNATIONAL ASSOCIATION OF FAIRS AND EXPOSITIONS

My name is Bligh A. Dodds, Gouverneur, N. Y. I am chairman of the Government Relations Committee and past president of the International Association of Fairs and Expositions. Also past president of the New York State Association of Agricultural Fairs, and a former director of the New York State Fair, Syracuse, N. Y. I am presently secretary-manager of the combined operation of two successful St. Lawrence County Fairs at Gouverneur, N. Y. Mr. J. S. Dorton, manager of the North Carolina State Fair, at Raleigh, who is now president of the International Association of Fairs and Expositions, and Mr. Frank Kingman, Brocton, Mass., secretary-treasurer of this association, are in complete accord and fully endorse the statement which is herewith submitted. We represent the 2,500 agricultural fairs in the United States.

Most of these fairs are from 50 to 150 years old. They have filled a need in American rural life, otherwise they could not have existed through this country's history. For generations, farmers of the United States have been given much valuable information about the newest developments in farm methods and machinery by visiting these annual expositions. A substantial percentage of these fairs are owned or operated by States, counties or communities, which also finance or subsidize a majority of them. This practice in itself is proof of the belief by the State, counties or communities in the educational value of these fairs.

In some States, the counties levy a millage tax on every citizen in the county to help finance their fair while State aid for fairs has been in effect for a great many years. Agricultural fairs are nonprofit organizations. They are basically educational, in fact one of the oldest institutions in American rural life.

If they were not, States, counties, communities and cities would not continue to finance their operations. If they were not, the Federal and State Governments would not take part in supporting them as they do through every form of youth organizations such as the 4-H clubs and the Future Farmers of America with their more than 8 million members, through the State colleges of agriculture and the extension services.

Agricultural fairs are exempt from real estate taxation and for many years have had exemption from other principal forms of taxation. It was, I believe, in recognition of the fact that fairs are nonprofit organizations and leading factors in the development of a better agriculture and better standard of living, not only on the farms but in the communities where held, that the Federal Government, State, county and town governments have exempted them from taxation.

It is pertinent to remind the committee at this point that fairs are a civic enterprise, that they operate in a majority of cases only 1 week or a part thereof during the year. They cannot be classified in any sense as a commercial enterprise.

During World War I President Wilson urged that fairs be continued to encourage greater food production. Railroads, then operated by the Government, lifted embargoes to permit transportation of exhibits to fairs. During World War II President Roosevelt emphasized the importance of agricultural fairs and the United States Government gave them permits to operate. The United States Department of Agriculture sent out special advertising to emphasize the importance of continuing the activities of these fairs. During World War II many departments of the Federal Government used the fairs as a means of reaching large masses of the people quickly. It is a matter of record that millions of dollars in war bond sales were directly traceable to the agricultural fairs.

For the last 30 years, the Interstate Commerce Commission has recognized the value of fairs. The present tariffs permit exhibits to move at one-half the regular tariff rates. This is but one example. For a long period of years the United States Department of Agriculture has had exhibits at fairs to disseminate agricultural information.

We cannot be classified as an amusement enterprise. Until 1941 and World War II, Congress exempted fairs from the Federal admission tax even while other events were taxed. They were exempted because they were educational and supported by State, county, and town governments. This condition has not changed.

Fairs provide a veritable university for their patrons. They serve the very worth-while purpose of attracting more people than any other public gatherings held in America offering the greatest opportunity for mass education. The present tax hits hardest the family man and thereby millions of American boys and girls. Admissions are the largest source of revenue for every fair. Any drop in this revenue quickly affects every department of the fair through the lowering of prize money—the discouraging of competition and therefore the reduction of the effectiveness of the fairs.

The admission tax is a tax on children, 12 years old or over, and this practice prevents the extension by fair managements the country over of providing either free or reduced prices of admission to large numbers of underprivileged children.

It is a tax on small business. Although the fairs in the aggregate are big business, to the individual fair unit it is small business. The average fair operates but 4 days out of 365.

It is double taxation. One-half of the States and many communities already charge an admission tax. In most of the States the rate usually ranges from 1 to 3 percent of gross receipts but in four States, 1 cent for each 10 cents.

Fairs are already caught between decreased revenues and increased costs. Long-term contracts have already been made for this fall's operations, which are now under way. Fair men have expected and planned on the elimination of this tax which we were told was placed on the fairs only for the war period.

Fairs are important factors in the economic and social life of our country. Here is an outlet providing for the display of the creative work of both young and old for the year. The agricultural fair is the show window for such efforts. The ability of the management to offer attractive awards and surroundings should not be hampered by taxation of this outlet for the accomplishment of rural youth.

Show me a boy or a girl who raises and fits a calf, a pony, a sheep, or a pig, who raises his own crops, who makes her own clothes, all for exhibit at the fair, and I will show you a boy or a girl who is too busy to attend juvenile court.

So in conclusion, gentlemen of the committee, we contend that no tax should be paid to see agricultural fairs.

We greatly appreciated the approval in 1947 and again in 1950 by the Ways and Means Committee of the House of Representatives and the subsequent approval by the House of a bill to do the very thing we are seeking at this time. There is much more factual information to present in behalf of our case, yet we have full confidence that your attitude toward us will be a kindly one and that if consistent with the Nation's best interest you will decide favorably on our request herewith submitted.

In behalf of President J. S. Dorton, and Secretary-Treasurer Frank H. Kingman, as well as the 2,500 member fairs of our association, I wish to thank you very much for the opportunity of presenting this testimony.

I respectfully request that this testimony be included in the official record of this hearing.

STATEMENT OF BLIGH A. DODDS, GOUVERNEUR, N. Y., CHAIRMAN OF THE EXECUTIVE COMMITTEE AND PRESIDENT EMERITUS OF THE NEW YORK STATE ASSOCIATION OF AGRICULTURAL FAIRS

The fairs of America vividly recall the difficulties with which we were beset during the years of World War II and the worries which we had in the beginning of that war as to whether we could continue our operations. It is a matter of record that we were finally given the green light and it is also a matter of record that the fairs, generally speaking, proved of great value in the successful prosecution of that war. Since last June we have been embroiled in another war of vastly different nature, yet because of this emergency and the necessity of mobilizing for national defense, the fairs have this time taken the initiative and early this year a resolution was passed at the annual convention in Albany, N. Y., of the New York State Association of Agricultural Fairs indicating to the Federal Government what our feelings are along this line. The resolution follows and may I respectfully request that it be included in the record of this hearing as a declaration of the policy in this emergency of the agricultural fairs of the State of New York.

"Whereas aggression by vast Communist forces in the world, and the threat of aggression by other forces, have made necessary the mobilization of all the country's resources for defense; and

"Whereas the New York State Association of Agricultural Societies, representing the 51 agricultural fairs of this State, have grounds, buildings, and housing facilities strategically located for serving the defense program of this State; and

"Whereas these facilities are well adapted to the mass education of our people, the dissemination of important information and encouragement of increased agricultural production: Now, therefore, be it

"*Resolved*, That this association, and the fairs here represented unqualifiedly offer their facilities to the local, State and national defense authorities and pledge their complete support to the preparedness program in this emergency."

Senator BYRD. Mr. Lanier.

Senator HOEY. Mr. Chairman, Mr. Lanier comes from North Carolina and represents tobacco people generally. I might say I do not know of a better informed man in the United States on the tobacco situation.

There are a number of North Carolina farmers up here, not expecting to be heard, but they did want to manifest their interest in the tobacco situation. They came themselves and paid their own expenses.

I would like for the men from North Carolina to stand. They represent the various farm organizations, the Farm Bureau, the Grange, and other farm organizations; and the tobacco growers of the State are interested vitally in this.

Senator BYRD. I would like the Virginians to stand up to see which are the best looking.

Senator MARTIN. Mr. Chairman, I am sorry we don't have our great tobacco growers from Pennsylvania here represented.

Senator HOEY. We have a representative from Pennsylvania out there. I met him a while ago.

Senator BYRD. Let's have him stand up, too.

Senator MARTIN. People don't generally realize that we produce an enormous amount of tobacco in the State of Pennsylvania. It is one of our great products.

Senator KERR. I do not believe that there are any Oklahoma producers here. They wouldn't have to stand up. They would not want to stand up in a contest as to who was the best producer, but that proposition the chairman laid down as to who was the best looking, I am sorry they are not here in order to eliminate any controversy in that regard.

Senator MARTIN. Mr. Chairman, I think our Pennsylvania fellows would look like they are very well fed men. They are Pennsylvania Germans.

Senator BYRD. We are sorry they are not here. You may proceed, Mr. Lanier.

STATEMENT OF J. C. LANIER, PITT COUNTY, N. C.

Mr. LANIER. Mr. Chairman, and gentlemen of the committee, my name is J. C. Lanier, and I live in Pitt County in North Carolina. My county is the largest tobacco producing county in the world. In 1950 it produced approximately 50 million pounds of flue cured leaf tobacco from 37,600 acres. Nearly all of this tobacco is the kind of tobacco used in the manufacture of cigarettes. My principal business is the growing of flue cured tobacco.

Cigarette tobacco is grown in the States of Virginia, North Carolina, South Carolina, Georgia, Florida, Kentucky, Tennessee, West Virginia, Ohio, Indiana, Maryland, and Missouri. More than 700,000 farm families are engaged in the production of this type of tobacco, and derive their major cash income from its sale. In my own particular area, tobacco is the pivotal crop; we are dependent upon it for our economic existence. We produce some corn, mostly for home consumption, a little cotton and a few potatoes, but tobacco is the basis of our economic life.

In my particular area tobacco is the heart and core of our economic existence. It is the big crop, the big industry; it is centralized and we depend upon it for the money to carry on and to live.

I want to make it clear to this committee that I do not appear as a paid representative of any segment of the tobacco industry. I am receiving no compensation directly or indirectly or in anywise whatsoever. I am appearing before you as a tobacco grower, as a member of the North Carolina State Grange Tobacco Committee, and as the chosen spokesman of the tobacco growers from all the States that product cigarette tobacco.

It is a great honor, but it is a great responsibility, and I just hope that I can today, before this committee, measure up to this responsibility by presenting to you gentlemen fairly and honestly the arguments that we have against this tax proposal.

If I can do that, I am more than well paid.

I am here today specifically to oppose the Treasury proposal to increase the Federal excise taxes on cigarettes from $3.50 per thousand to $5 per thousand.

In terms of a pack of cigarettes, the proposal is to increase the tax from 7 cents a pack to 10 cents a pack.

In terms of a pound of tobacco, which I have here in my hand, it means that the tax on that pound of tobacco will go from $1.17 a pound, which it now is, to $1.67 a pound.

The grower for that pound of tobacco gets 50 cents. That is the average over the past 3 years.

The Government now takes an excise tax on that pound of tobacco 2⅓ times the total gross return of the farmer, and if Mr. Synder's proposal is accepted, the Government will get 333 percent times the amount of money that the grower got for producing that pound of tobacco.

Senator BYRD. Will you repeat that, please?

Mr. LANIER. At the present rate of tax the Government gets $1.17 tax on that pound of tobacco going into cigarettes. The farmer gets 50 cents gross for all his work in producing that pound of tobacco.

If the Treasury proposal were adopted and the tax should go up to $5 a thousand, the Government then will get 333 percent times the amount the farmer got for growing the tobacco.

I say to you from the standpoint of 2 million people living on the farms, and producing this tobacco, that no other commodity in this country has ever been taxed, or proposed to be taxed in that monstrous, fantastic proposal, and in that proportion.

We tobacco growers are willing to pay more taxes. We know the country has to be rearmed. I am a veteran of the First World War, and I am willing to pay more taxes. I want the country armed to the teeth. But I think that taxes ought not to be levied on one particular little industry like tobacco. I think that it should be spread across the board, and then if you increase our income taxes or any other taxes that go across the board, we are more than willing to pay our part, but we do not think that this Congress should single out tobacco, that already carries the fantastic tax load that it now carries, $2 billion a year now, and add more to it, because we know if you do that, you are going to lessen our ability, the people who grow tobacco, these people who came up here today at their own expense, to pay any further tax.

In every single crisis, gentlemen, tobacco has been singled out to bear more than its share of taxes. Once a tax is proposed on tobacco and levied, Senator Hoey, it becomes as fixed and immutable as the laws of the Medes and the Persians.

In every war beginning in 1914, they have added, pyramided these taxes on cigarettes, and not one has ever been reduced in peacetime, and now in this twilight zone of war and peace, they propose to add a 40-percent tax on top of the tax that we are now paying on this tobacco.

I want to put this in terms of the grower. As I said the tobacco that goes into one pack of cigarettes, for that tobacco the grower now receives 3 cents. That is the total take for that tobacco. The Federal Government now gets 7 cents for that same tobacco and there is no complicated manufacturing process whereby you take a raw commodity and work on it and build up the value like in an automobile, a hundred dollars worth of steel makes a $3,000 automobile.

A cigarette is just tobacco wrapped up in a piece of paper, that is all it is. Yet they more than double at the present rate of taxation what the farmer got for the raw commodity—already.

Let us apply this, and I want to read this because it has got some figures I want to get correct—let's apply this to the production of a tenant farmer. He is what we referred to in the past as a one gallus man. Now, the average acreage of a tenant family of tobacco in the flue-cured area, is something less than 4 acres. In the burley area, in the Tennessee area, it is less than that.

Senator KERR. I wonder if you would explain to me the difference between those two terms.

Mr. LANIER. Which two terms, Senator?

Senator KERR. You talk about flue-cured and burley.

Mr. LANIER. The flue-cured tobacco is grown in Virginia, North and South Carolina, Georgia, and Florida, and that is cured by putting it in a barn and applying heat about 5 days and nights. You cure it by heat with flues in a barn. That is called flue-cured tobacco.

In the burley area of West Virginia, Ohio, Kentucky, Tennessee, and Indiana, they cure it by hanging it in an open shed and let the air cure it. They don't use heat.

Senator KERR. Is it about the same products when they start?

Mr. LANIER. Yes, sir; it is a different variety, but it looks much like that. They are commingled to make the so-called American standard-brand cigarette.

Senator KERR. The reason I was asking that, I gathered that you said in the flue-cured area they could farm about 4 acres, and in the other I gathered you said about 3 acres.

Mr. LANIER. Less than three; yes, sir.

Senator KERR. Is that caused by other conditions than the manner in which they cure the tobacco?

Mr. LANIER. Yes, sir; it is because, in the burley areas, in the mountains of Tennessee and Kentucky, the average grower does not have as much tobacco acreage as they do down in the old flue-cured area.

Senator KERR. If he could get the acreage, he could take care of four as easily as the other fellow does; is that right?

Mr. LANIER. That is right.

The average cash value of tobacco produced by a tenant family on 3 acres is $1,875. That is the average over the past 8 years.

Senator BYRD. Is that the total cost?

Mr. LANIER. That is the total gross selling price, Senator, of which the tenant farmer gets one half, or $937.50.

Of course, he has got some other litle crops—pigs, a little corn, a little cotton—but tobacco is what he depends on to pay for his fertilizer, to pay his taxes, to pay his living expenses, and buy the necessities of life. It comes from tobacco.

At the present rate of excise taxes now, the Government collects $1,455 from every acre of this tobacco that goes into the making of cigarettes, $1,455.

On a tenant farmer's crop of 3 acres, now collects, if it goes into cigarettes—and most of it does, practically all of it does—the Government collects $6,242 off of the production of tobacco, Senator, on one tenant farmer.

Senator MILLIKIN. Let me ask you this: The higher the tax on the finished product, does that not back up on the grower and have a tendency to reduce his price, or what is the economics of that?

Mr. LANIER. I was coming to that in just a moment.

Senator MILLIKIN. All right.

Mr. LANIER. I hope that these figures will be imbedded in the minds of you gentlemen because never has a condition like this faced an industry. If tobacco had not been taxed up until now and you gentlemen were looking for new sources of revenue now and someone came across tobacco and someone would suggest that it be taxed as fur coats are, taxed 20 percent of its value, you might adopt it, or 50 or 100, but if it came as a new thing and someone said, "Let's tax it 300 percent of its value," I believe it would shock the conscience of the committee.

Let me relate this tax to my own operations in growing tobacco. I am not a large grower, but last year I produced on the farms that I have 72,000 pounds of tobacco and it sold for around $40,000.

Eleven farm families participated in that production.

The Government, off of the tobacco I produced last year collected in cigarettes $85,000 on my own crop of tobacco, and if the Secretary's proposal were adopted, it means they would tax my tobacco $120,000 in one crop.

One other illustration. Last year Pitt County produced 50,000,000 pounds of tobacco, a purely agricultural county. The Government collected on that tobacco $60,000,000 and if the proposal that the Secretary makes is adopted, they would collect $85,000,000. That is nearly twice the assessed valuation of every bit of property in that country.

Of course, the producer does not pay this tax. Even a magician could not take 50 cents and pay $1.17 tax, let alone $1.67.

But what this tax does is to put a terrific burden upon the flow of our tobacco into normal channels of commerce. We are operating now under a restricted acreage.

Up until this year we had been cultivating only 70 percent of our basic acreage in this type tobacco. It was raised to 84 this year, but we have yet not gotten to a normal production, 100 percent of our allotted acreage.

We believe that if this tax should be increased, it will have a terrific impact upon the use of cigarettes in this country; and if by reason of the tax the consumption of cigarettes should be diminished, then it means economic disaster to us who, in the last 15 or 20 years have gotten somewhat away from Tobacco Road.

Should any considerable segment of the smoking population go to pipes or roll-your-owns, the impact will be terrific, not only upon us, the producers, but upon the Treasury of the United States.

The Federal Treasury stands to lose and not gain by the imposition of this 3 cents extra, or any part of it, because every time that 1 man out of 10 who smokes cigarettes quits, it costs the Government over a hundred million dollars, and every time a smoker smokes 1 pack less out of 10, the Treasury will lose over a hundred million dollars.

Gentlemen, this tax singles out one particular farm commodity for the most onerous tax ever levied. It is the only farm commodity that carries any tax except the grains that go into liquors and the grapes that go into wine. No tax is levied on wheat grown in Kansas or cotton in Mississippi or fruits in California or corn in Iowa or Ohio.

None of those farm commodities bears any tax, and I certainly am not speaking to indicate that there should be.

But here they pick out tobacco and in the face of the fact that it carries now a load of taxation of over $2,000,000 a year, they want to add another 40-percent increase on this tax.

Senator MILLIKIN. From the standpoint of the grower you contend, first, that the weight of this tax may lessen the market for the end product, No. 1, is that right?

Mr. LANIER. Yes, sir.

Senator MILLIKIN. No. 2, it exercises a pressure against the price that the producer might otherwise get if there were not such heavy taxes on the end product; is that correct?

Mr. LANIER. Yes, sir; that is right. Those are two of the very straight points that I am trying to make.

Gentlemen, this tobacco industry has had a great growth, and along with the growth the Treasury has benefited, the taxes have increased until now last year the Federal Government collected over $1,300 million on cigarettes.

Is this to be the situation? Are we to be harassed because we have a growing industry and because we have been able to make a reasonable living out of this? We sometimes think and ask whether or not the power to tax is not being used to destroy us who are engaged in the production of tobacco.

There are a thousand commodities in the category with tobacco—coffee, tea, golf balls, hunting equipment—a thousand articles that are in the same category, but they bear no such burden as we bear.

Tea and coffee are very comparable to tobacco, but not a cent of tax is collected on coffee or on tea.

Why is it that the Brazilian coffee growers' product is tax-exempt?

Why is it that the Java tea growers' product is tax exempt? And yet the product of the tobacco grower is taxed, and taxed and taxed until it seems there is no limit to where they are trying to go.

There is one other point I would like to make, and that is that this tax lays a heavy hand upon the family budget of the people least able to pay. At the present rate of taxation a man who smokes one pack a day pays $25.55 a year in excise taxes on his smokes.

If the taxes increase, he will pay $10 more, and if an average family worker with a wife and two children, using a pack of cigarettes a day, he would then pay under this Treasury proposal twice as much in tobacco excise taxes as he pays in income taxes.

Senator BYRD. You are speaking only of Federal taxes?

Mr. LANIER. Yes, sir, Federal only.

Senator BYRD. Do you have any figures as to the State and local taxes on tobacco?

Mr. LANIER. Yes, sir.

The best computation we had last year indicated tobacco paid $1,800,000,000-some-odd in excise taxes to Mr. Snyder and paid over $500,000,000 in State, county, and municipal taxes.

If this proposal were to be adopted, gentlemen, the tax load on tobacco per year would be over $2,500,000,000.

This tax follows the path of least resistance, but it does not stretch across the board. I hold no commission for the wage earner nor the laboring man to present his side of the matter. I think it should be pointed out that the impact of the taxes would be tremendous on the household budget of these people in the low-income bracket.

At a recent referendum in Oregon as to the question of putting in a tax on cigarettes, it was overwhelmingly defeated by the voters of Oregon.

There is an area known as the area of diminishing returns, and when prices reach a certain level, they inevitably drop off.

Last year in South Carolina the legislature increased the tax on cigarettes from 2 cents to 5 cents. They tried it 1 year, and the next year they repealed it because it did not yield the revenue. It resulted in a decrease in smoking, and so the legislature, after 1 year, cut it out and went back to the 2 cents.

There is already, gentlemen, increasing evidence that the point of diminishing returns has been reached in the taxing of tobacco. For nearly half a century the consumption of cigarettes in this country has mounted steadily, but now it has leveled off.

From 1900 to 1910 the consumption doubled; from 1910 to 1920 the consumption increased over 500 percent; from 1920 to 1930 it nearly doubled again, and from 1930 to 1940, it again doubled.

But since 1943, when they put on this last increase, the rate per capita has been smaller—that is, the rate of increase per capita has been smaller than any similar period since 1900, and in the last 2 or 3 years it has almost leveled off entirely.

This has come about when national income, individual incomes, have skyrocketed.

Since 1943 personal incomes have increased 60 percent, but the per capita consumption of tobacco, cigarettes, has increased only 10 percent.

In the last 3 years there has been practically no increase whatever.

In the face of these facts, I think it fair to assume that from now on the consumption of cigarettes will increase in sensitivity to prices and any price increase will meet with increased sales resistance.

Under any fair appraisal of this situation, gentlemen of this committee, I think the committee and Congress should look at this proposal from a business standpoint.

Tobacco is one of the most fruitful sources of revenue that the Government has.

Is the Congress willing now to take a chance on pricing this product out of the market? Is it willing to jeopardize the rights and the best interests of the growers on this wild-goose chase for additional revenue, and is it willing to crucify the tobacco farmers upon this cross of inequitable taxation?

Gentlemen, there are two other segments of the industry, the wholesale distributor, the retail cigarette dealer, who are bitterly opposed to this tax.

There are thousands upon thousands of firms engaged in wholesaling and 2,000,000 retail outlets.

But I will not take the time to argue that point of view, because I am not too familiar with it, and I therefore request permission to insert into the record a statement by Mr. Eric Calamia, the managing director of the Retail Tobacco Dealers of America, Inc., and a statement by Mr. Claude Harrison, the past president of the National Association of Tobacco Distributors.

I will request permission to insert in the record a table showing the existing State and Federal and municipal taxes in the several States; second, the yield of Federal cigarette tax and the amount of tax per capita; third, cigarette tax-rate increases imposed by the Federal Government since 1901; fourth, Federal and State cigarette taxes compared with the Federal income tax liability; fifth, chart showing division of retail price of a pack of cigarettes; and sixth, a graph showing the rate of increase of cigarettes since 1900.

That is my statement, gentlemen. I appreciate highly the honor that I have had to come before this committee and the privilege of speaking in behalf of all these people, who have come up here today of their own accord. You have given me a very nice hearing. I appreciate it and I believe you will heed our plea against this tax.

Senator BYRD. Thank you, sir. The insertions will be made in the record.

(The documents referred to follow:)

RETAIL TOBACCO DEALERS OF AMERICA, INC.,
New York, N. Y., August 9, 1951.

Re: A solemn protest against any increase in Federal Excise taxes on cigarettes

To the Members of the Senate Finance Committee:

This association, speaking for thousands of tobacco retailers of the country, begs to register herewith its protest against any increase in the Federal excise tax on cigarettes, and respectfully submits the following facts and data which we feel clearly demonstrate the devastating effects of the present overburdensome cigarette taxes.

AN ENORMOUS BURDEN ON THE CONSUMER

Inasmuch as the millions of smokers in the country are our customers, we feel entitled, moreover impelled, to speak also in their behalf. The fact is that every package of 20 cigarettes is subject today to a Federal tax of 7 cents. To this must be added various State taxes ranging from 1 cent per package to 8 cents, and this onerous State tax burden is borne by the consumer in 41 States.

The average smoker purchases one pack a day. Thus, he already pays an annual cigarette tax to the Federal Government of 7 cents a day, amounting to $25.55, a large amount in itself. The disproportion of it becomes even more apparent when we realize that the Government buys these cigarettes from the manufacturer for $3.55 a thousand upon which the present Federal tax alone is $3.50 a thousand.

When taxes climb until the consumer pays more to the collector than he pays for the product, they become not only unfair but ridiculous. The very fact that an increase in excise taxes was imposed in World War II which has never been rescinded, makes the imposition of an additional tax at this time without reason and unconscionable.

In a great many families there are several members who smoke, in which case the aggregate Federal cigarette tax amounting to $50 a year or more exceeds their Federal income-tax payment—truly an excessively heavy tax drain on the middle- and low-income family budget.

Considering the enormity of this tax burden, is it any wonder we anticipate that the consumer will eventually rebel against this disproportionate burden and curtail his smokes? When this well-known point of diminishing returns is reached the tremendous cigarette revenue accruing to the Government will be affected as will our businesses.

TAX DISREGARDS ABILITY TO PAY

We dealers know the havoc worked upon our business by the difference of a single penny in the price of a package of cigarettes. On such an everday item the saving of a penny a day is vitally important to the great mass of consumers, and they will go to extreme lengths to make that saving. In fact, experience has all too clearly demonstrated that it is almost certain business suicide for a cigarette dealer to charge a penny more per package than his competitors.

It is easy to understand why, for the fact is that about 90 percent of the cigarettes sold are bought by poor or middle-income-bracket families. Then too, it must be remembered that an article so universally used and which affords the comfort and solace so much needed in these times, is in no sense a luxury. This is not an idle assertion, for in the military and naval services, tobacco next to food and clothing is considered of greatest importance to the maintenance of morale. In peaceful civilian pursuits it plays a similar role, and in these times of heavy taxation the retailers will be faced with great consumer resentment if there is any advance in price due to an increased tax.

EFFECT OF THE PROPOSED INCREASE ON TOBACCO RETAILERS

The vast number of small tobacco retailers today barely eke out a living on the sale of tobacco products. Of all items we vend, cigarettes provide the smallest mark-up, namely 17½ percent on our cost or 14½ percent gross profit. According to a survey conducted by Dun & Bradstreet the cost of doing business for a retail tobacco store ranges from 20.2 to 30.1 percent. On the face of these figures a tobacco retailer could not continue in business if he did not augment the sale of cigarettes by more profitable items. Thus the retailer actually carries cigarettes because of their value as a traffic builder.

Any increase in the present Federal excise tax will affect the volume of business we enjoy through the sale of cigarettes. Experience has proved that the cigarette purchaser is more price conscious than any other consumer and that he will shop for this commodity in those establishments where he can save 1 or 2 pennies per package. If we lose our cigarette customers to the cut-price practitioner who carries tobacco products as side lines and sells cigarettes at cost as loss leaders, we lose a customer for the other items we vend. It is the loss of these sales, in addition to a sharp decline of our cigarette volume which makes us extremely apprehensive as to the results of an increase in the Federal excise tax.

One other point we wish to commnd to your attention in considering any increase in this tax is that of the credit position of the small independent retailer. Because of the small margin of gross profit on the sale of cigarettes, which is actually insufficient to cover our cost of doing business, the average independent retail dealer is ill prepared to invest another $5 on every case of cigarettes he purchases. Muy thousands of small retailers would be badly hit by this factor alone, and the entire economic structure of the independent retailer will be dislocated with resultant hardship on the distributors as well.

In justice to the masses of consumers and the many thousands of tobacco dealers and their families, who are largely dependent upon the volume of their cigarette business, we most urgently and respectfully request that the proposed increase in Federal excise tax on cigarettes be abandoned.

RETAIL TOBACCO DEALERS OF AMERICA, INC.,
By ERIC CALAMIA, *Managing Director.*

STATEMENT OF CLAUDE HARRISON, OUACHITA CIGAR & TOBACCO CO., MONROE, LA., PRESIDENT OF THE NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

Mr. Chairman and members of the committee, I appear as president of the National Association of Tobacco Distributors. I am also president of the Ouachita Cigar & Tobacco Co., of Monroe, La.

I come from a State where per capita we spoke more hand-made cigarettes and more different brands of cheap-type roll-your-own than any other State in the 48, because our State collects the highest State tax in the Nation. In addition to the present Federal tax of 7 cents per package.

Every loyal and patriotic American citizen, of course, realizes that building and sustaining a large national defense program to preserve our precious American way of life requires the expenditure of enormous sums of money. In addition, each of us appreciates the fact that taxes in divers forms must be levied by our Government to secure the needed revenue. However, in speaking for the Nation's several thousand wholesale tobacco distributors and their million and a quarter retailer-customers, we wish to point out to this committee the inevitable pitfalls and inequities in the proposed increase of Federal excise tax rates on cigarettes and cigars.

It is scarcely necessary to point out that cigarettes and cigars are already dangerously saddled with exorbitant Federal, State, county, municipal, and other local taxes.

What is puzzling to us is that there seems to be an insatiable desire by some to repeatedly pick on cigarettes as the scapegoat to bear the brunt of more and more taxation. We sometimes wonder why even some officials constantly single out for discriminatory treatment a product that (1) provides so much pleasure to millions of persons in this country and all over the world; (2) yields close to $2 billion annually in taxes; (3) is growing in public acceptance and as such should be helped and safeguarded instead of placing roadblocks in its way; (4) helps so many people to earn a livelihood, so many farmers to operate with a reasonable measure of success, and so many small merchants to conduct modest businesses; (5) is responsible for investments in taxes alone of millions and millions of dollars; (6) provides so wonderful a "lift" and gives so much deserved pleasure to the men in the armed services; (7) already groans under a tax system whereby stamps must be purchased for cash and manufacturers and wholesalers are required to carry substantial inventories of such stamps and extend credit which includes the cost of the stamps; in fact, purchasers of these stamps act as "bankers" for the Federal and State Governments. Lest we forget, may I point out that there are very few other products which can make this claim: Nothwithstanding an increase of 80 percent in the cost of the basic material (in this case tobacco) and substantial increases in the manufacturer's, wholesaler's, and retailer's over-all cost of operation, the price of cigarettes, exclusive of additional taxes, has risen only a penny a package. That certainly speaks well for the efficiency and skill of a progressive industry. Why penalize it?

What are we in the tobacco industry confronted with now? The Treasury has recommended that cigarette taxes be hiked by more than 40 percent, thereby endeavoring to saddle us with the staggering burden of obtaining 40 percent additional capital to operate a $4,000,000,000 business. It is not difficult to visualize what this condition would mean to the small distributor with a capital investment of $15,000. He would be required to try to find $10,000 of additional capital, which is a burdensome task for a businessman who is already operating on a shoestring. The retailer whose investment is, say, $1,500 would have to scrape the barrel to stay in business. What havoc it would create with our entire credit structure, especially among the hundreds of thousands of small accounts who are devoid of mercantile ratings and who are already hard put to obtain essential credit to subsist in business.

Various congressional committees have spent years and untold sincere efforts to devise ways and means of preserving the small merchant as a symbol of the American way of life. Should the proposed 40 percent increase in the cigarette tax become law, it would be crippling to the businesses of the hundreds of thousands of small merchants in this country, who, generally speaking, are constantly skirting business insecurity. The net effect would be that Congress would thereby be tossing into the hands of the large chains and other giant enterprises the businesses of these small merchants. It is only too tragically obvious that this would further complicate the already challenging problem of preserving the small merchants in our economy.

We are fully cognizant, as already stated, that huge amounts of revenue will be necessary to operate our Government in the trying period ahead. But in all fairness and equity we ask whether the tobacco industry isn't already doing more than its share. It has consistently been the second largest revenue producer and it does not object to paying its fair share of taxes, but it is distressed at any suggestion that more and more taxes should be imposed on its products merely because it has been an expanding industry. Frankly we have always felt that it is inherent in our American way of life to encourage the growth of industry. Let us not overlook the fact that the tobacco industry's greatness is in effect the sum total of 2,000,000 tobacco farmers who by and large, are modest citizens; a million and a quarter retailers who are, in the main, small merchants; and 6,000 wholesalers most of whom are small-business men.

We believe if small-business men are to survive, that they should not be expected to bear the financial burden involved in an inequitably high additional tax.

With respect to the proposed increase of the Federal excise tax on cigarettes from \$3.50 to \$5 per thousand—or an additional 3 cents per package—the tobacco wholesaler would find himself on the horns of a dilemma.

Since he must pay the Federal tax direct to the manufacturer as part of his invoice cost of the cigarettes, it would require that he invest additional capital to enable him to purchase the same quantity of cigarettes. In accordance with trade policy, wholesalers are required to pay their invoices on a basis that virtually is tantamount to cash. This necessary additional capital investment would, in most cases, disrupt the normal financial condition of numerous firms. This is so because, as a matter of sound wholesale business procedure, there is a direct relationship between the amount of capital in a business and the volume of sales, which is recognized as a safe operating ratio. For example: The average tobacco wholesaler capitalized at \$15,000 tries to maintain a sales volume of approximately \$500,000 and would consider it hazardous were his sales to exceed that amount by any great extent. Therefore, the requirement for greater capital, if unavailable, could have the effect of forcing the wholesaler to curtail his unit volume of sales in order to maintain the same dollar volume, with the probability of reduced yields at a time when costs of operation continue to skyrocket.

There is still another serious problem that would confront the tobacco wholesaler in the event of an increased Federal cigarette tax. I refer to the matter of credit extension. It is a the policy to tobacco wholesalers to extend credit to their retailer customers on sales of cigarettes for periods of 30 days and more. Since an additional tax would increase the amount of credit extended by the wholesaler for the same quantity of merchandise, the wholesaler would be further jeopardizing his business by increasing his credit risk, unless he chose to sell less merchandise to his customers with a consequent diminution of revenue.

Let us examine the amount of additional capital that a typical wholesale tobacco distributor would have to obtain were the new tax to go into effect. Such a wholesaler having a gross volume of \$500,000 annually would probably average 75 percent of his total sales in cigarettes, or \$7,500 per week. This represents approximately 77 cases of cigarettes per week. The proposed excise tax would increase the cost to the wholsaler by \$17 per case. This would mean that the small wholesaler would have to invest over \$1,300 additional capital in order to maintain his present volume of cigarette sales.

Since he must maintain credit for the retailer on an average of 4 weeks' duration, it means that the wholesaler would have to have available \$5,200 additional capital to maintain the additional capital to maintain the additional credit required by the increased taxation. In addition to this credit extension, the wholesaler normally has 1 week's supply of cigarettes on hand at all times. This capital investment would also have to be increased by \$1,300 to maintain the additional cost of Federal excise-tax stamps, thus entailing \$6,500 added capital. Accordingly, a wholesaler with an investment of \$15,000 in his entire business would find himself faced with the necessity of increasing his capital investment to accommodate the tax increase of over 40 percent, at a time when credit restrictions are becoming more and more evident and little cash is available to him.

Assuming that he were fortunate enough to be able to obtain a commercial loan of \$6,500, the wholesaler would have to pay an interest rate of 6 percent, or \$390 per year, on this additional capital. In view of the fact that the wholesaler's total net profit for the year on this volume of cigarettes averages less than $800, it is obvious that the interest rate alone on the additional necessary capital would take away almost 50 percent of the wholesaler's net profit from his total cigarette volume.

Observing the picture from a broad national standpoint, wholesale tobacco distributors sell $2.1 billion worth of cigarettes at wholesale annually. Since the proposed tax hike would increase the dollar volume of cigarettes by more than 21 percent at wholesale, tobacco wholesalers generally would have to obtain over $40,000,000 in additional capital to finance their increased inventory cost and the cost of carrying their accounts receivable, which would be inflated by the amount of the proposed tax increase.

Still another effect of an increased tax on the tobacco wholesaler's business would be an increase in other operating costs. These would include increased insurance rates due to the higher value that would be placed on his inventory, State inventory taxes, and kindred expenditures. By the same token the impact on the hundreds of thousands of retailers would be just as severe.

Thus, it can be readily seen that there would be painful dislocations in the wholesaler's business due to an increased cigarette tax. He would have to invest huge additional amounts of capital in order to do the same amount of business. He would have to assume greater credit risks to the extent of the additional tax, and his operating costs would increase substantially.

May I, in passing, also note that the manufacturers of cigarettes, too, whose permanent investment in cigarette stamps approximates $70,000,000, would similarly be confronted with an acute refinancing problem.

On the question of the proposed increase in the Federal excise tax on cigars from $2.50-$20 to $1.50-$37.50, we wish to point out to this committee certain facts concerning the effect of such a tax increase on wholesale distributors.

Since the cigar industry has been declining for many years and is an industry which is uppermost among those which are least able to bear higher taxes, the plight of the tobacco wholesaler who depends in great measure upon cigars for a livelihood is a serious one. Because of the extremely low profits on other tobacco products generally, the wholesaler depends to a great extent upon the sale of cigars to enable him to sustain in business and to continue serving the more than 1,250,000 retailers who keep the Nation's consumers uninterruptedly supplied with tobacco products and other merchandise.

Among the ills attributed to the cigar industry is the fact that the product has been virtually priced out of the market. Experience has shown that even slight price increases on cigars are sharply repulsed by smokers. To advance further the cost of cigars to the consumer by increasing the tax rate would have dire consequences on the industry at all levels—the manufacturers, retailers, and the farmers who grow cigar-leaf tobacco, as well as the wholesalers.

In short, the cigar industry has reached a critical state, whereby this committee will have to decide whether to increase the tax and actually crucify it or reduce the tax and give the industry a chance for survival.

We therefore urge that this committee carefully weigh the consequences of the proposed increase in Federal excise tobacco-tax rates, both on cigarettes and cigars, in order to avoid irreparable harm to the tobacco industry and dislocation to the businesses of the Nation's wholesalers and retailers of cigarettes and cigars, the preponderant majority of whom typify small business, the bulwark of the free-enterprise system.

EXHIBIT No. 1

Cigarette taxes (per package)

[In cents]

State	Federal	State	Municipal	Total current taxes	Total if Federal excise is increased
Alabama	7	3	2	12	15
Arizona	7	2		9	12
Arkansas	7	4		11	14
Connecticut	7	3		10	13
Delaware	7	2		9	12
Florida	7	5	5	17	20
Georgia	7	5		12	15
Idaho	7	3		10	13
Illinois	7	3		10	13
Indiana	7	3		10	13
Iowa	7	2		9	12
Kansas	7	3		10	13
Kentucky	7	2		9	12
Louisiana	7	8	1	16	19
Maine	7	4		11	14
Massachusetts	7	5		12	15
Michigan	7	3		10	13
Minnesota	7	4		11	[illegible]
Mississippi	7	4		11	14
Montana	7	4		11	14
Nebraska	7	3		10	13
Nevada	7	3		10	13
New Hampshire	7	3		10	13
New Jersey	7	3	2	12	15
New Mexico	7	4		11	14
New York	7	3		10	13
North Dakota	7	5		12	15
Ohio	7	2		9	12
Pennsylvania	7	[illegible]		11	14
Rhode Island	7	3		10	13
South Carolina	7	5		12	15
South Dakota	7	3		[illegible]	13
Tennessee	7	[illegible]		[illegible]	15
Texas	[illegible]	4		[illegible]	14
Utah	7	2		9	12
Vermont	7	4		11	14
Washington	7	4		11	14
West Virginia	7	1		8	11
Wisconsin	7	3		10	13
Wyoming	7	2		9	12

EXHIBIT No. 2

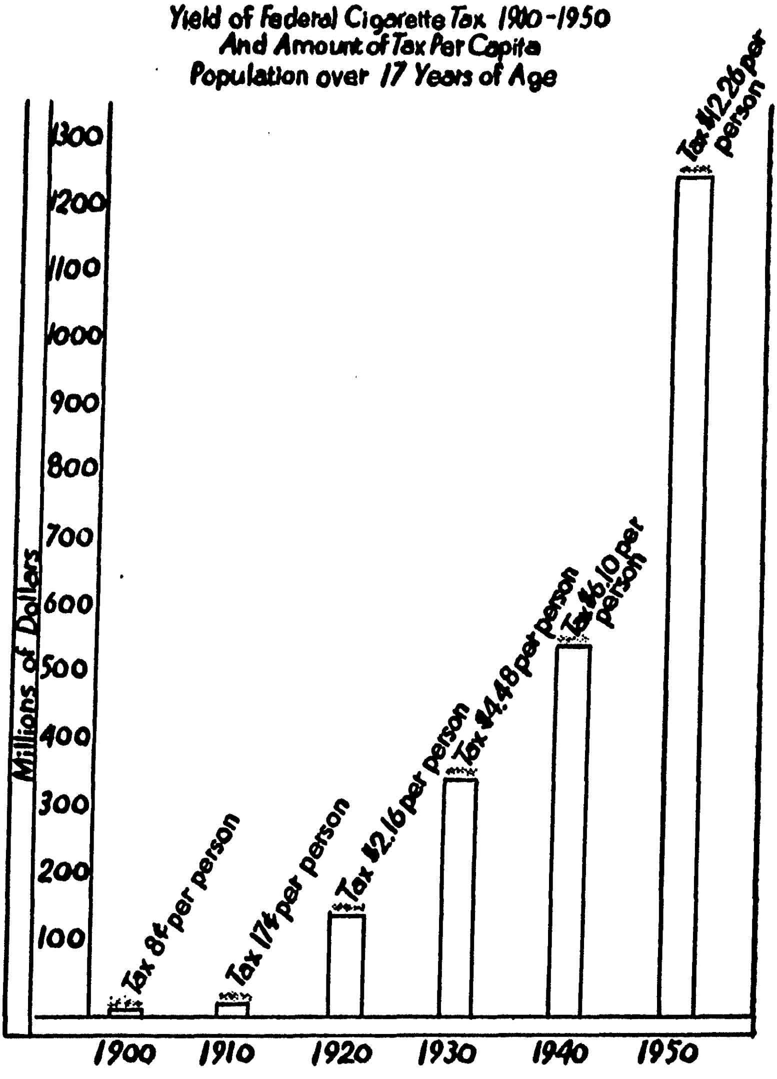
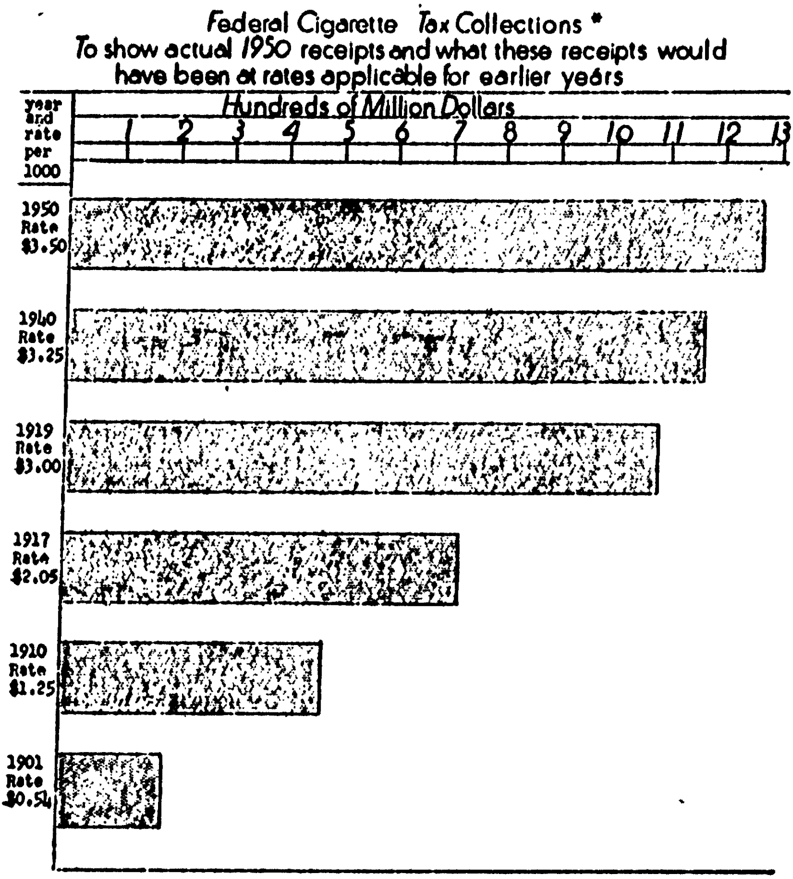

Yield of Federal Cigarette Tax 1900-1950
And Amount of Tax Per Capita
Population over 17 Years of Age
Millions of Dollars
1300
1200
1100
1000
900
800
700
600
500
400
300
200
100
Tax 8¢ per person
Tax 17¢ per person
Tax $2.16 per person
Tax $4.48 per person
Tax $6.10 per person
Tax $12.26 per person
1900
1910
1920
1930
1940
1950

EXHIBIT No. 3



*The bars presented in the chart above are designed to show the effect of successive tax rate increases imposed by the Federal government since 1901. The top bar reflects the yield of actual Federal cigarette tax collections for the calendar year 1950 in the amount of $1,262,705,187. The second bar shows the tax that would have been paid in 1950 if the rates applicable in 1940 had been applied. The successively lower bars show what the 1950 tax collections would have been had the rates prevailing for the earlier years. been applied to the 1950 production.

EXHIBIT No. 4

Federal and State cigarette taxes compared with Federal income-tax liability for various income groups

Adjusted gross income	Number of returns filed	Total income taxes	Average tax per return	Federal cigarette tax, 1-pack-a-day smoker [1]		2-cent State tax tax added [2]	
				Amount	Percent	Amount	Percent
Under $1,000	7,771,021	$37,706,000	$4.85	$25.55	526.8	$32.85	677.3
$1,000 to $1,999	11,145,284	622,438,000	55.85	25.55	45.7	32.85	58.8
$2,000 to $2,999	12,459,410	1,619,226,000	129.96	25.55	19.7	32.85	25.3
$3,000 to $3,999	9,396,744	1,990,235,000	211.80	25.55	12.1	32.85	15.5
$4,000 to $4,999	5,094,747	1,687,046,000	331.13	25.55	7.7	32.85	9.9

Adjusted gross income	3-cent State tax added [3]		4-cent State tax added [4]		5-cent State tax added [5]		6-cent State tax added [6]		8-cent State tax added [7]	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Under $1,000	$36.50	752.6	$40.15	827.8	$43.80	903.1	$47.45	978.4	$54.75	1,128.9
$1,000 to $1,999	36.50	65.4	40.15	71.9	43.80	78.4	47.45	85.0	54.75	98.0
$2,000 to $2,999	36.50	28.0	40.15	30.9	43.80	33.7	47.45	36.5	54.75	42.1
$3,000 to $3,999	36.50	17.2	40.15	19.0	43.80	20.7	47.45	22.4	54.75	25.8
$4,000 to $4,999	36.50	11.0	40.15	12.1	43.80	13.2	47.45	14.3	54.75	16.5

[1] No State cigarette tax: California, Colorado, Maryland, Missouri, North Carolina, Oregon, and Virginia.

[2] 2-cent State tax: Arizona, Delaware, Iowa, Kentucky, Ohio, Utah, and Wyoming.

[3] 3-cent State tax: Alabama, Connecticut, Georgia, Idaho, Illinois, Indiana, Kansas, Michigan, Nebraska, Nevada, New Hampshire, New Jersey, New York, Rhode Island, South Carolina, South Dakota, and Wisconsin.

[4] 4-cent State tax: Maine, Minnesota, Mississippi, Montana, New Mexico, Pennsylvania, Texas, Vermont, Washington, and West Virginia.

[5] 5-cent State tax: Florida, Massachusetts, Oklahoma, and Tennessee.

[6] 6-cent State tax: Arkansas and North Dakota.

[7] 8-cent State tax: Louisiana.

EXHIBIT No. 5

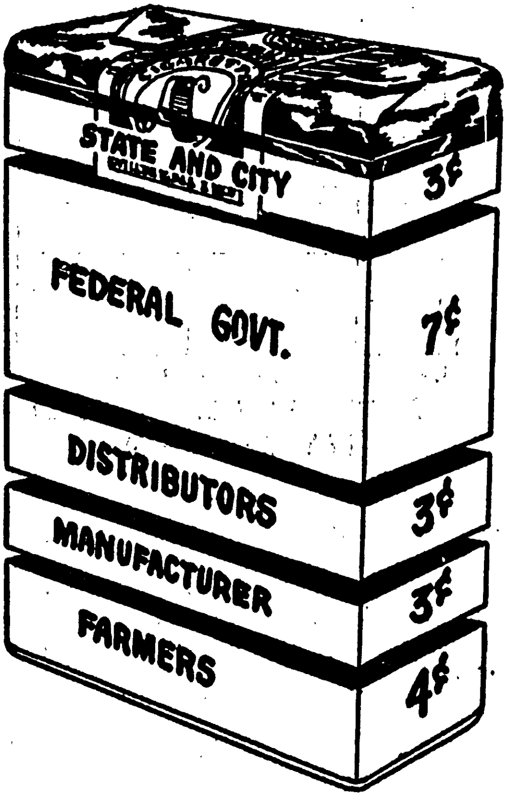
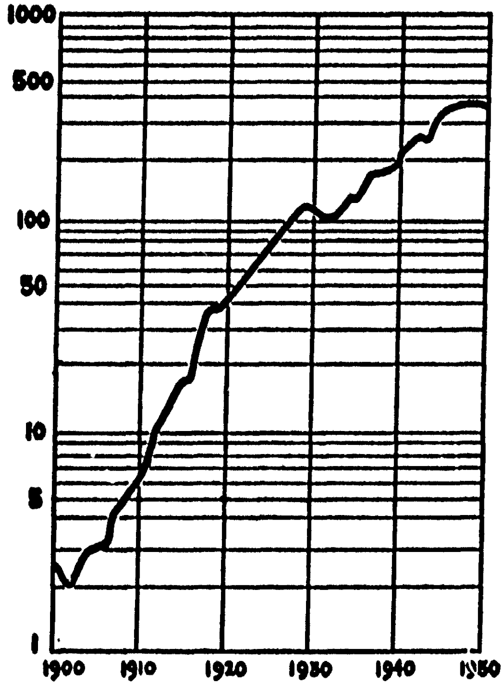

STATE AND CITY
3¢
FEDERAL GOVT.
7¢
DISTRIBUTORS
3¢
MANUFACTURER
3¢
FARMERS
4¢

EXHIBIT No. 6



BILLIONS OF CIGARETTES CONSUMED BY YEAR-1900-1950

—3—

Senator HOEY. Mr. Chairman, Mr. Perry Caldwell, master of the Grange in North Carolina, and Mr. Flake Shaw, executive vice president of the Farm Bureau, would like to insert a statement. They will not ask the time of the committee to make a statement here, but Mr. Caldwell, will you come up, and Mr. Shaw. We would like to have their statements.

Senator BYRD. We will be very glad to have those insertions made.

STATEMENT OF PERRY CALDWELL, MASTER OF THE GRANGE, STATE OF NORTH CAROLINA

Mr. CALDWELL. Mr. Chairman, Mr. J. C. Lanier, a member of our tobacco committee, spoke for the North Carolina State Grange here today.

In addition to representing all the different interests, he was officially speaking for the North Carolina State Grange, and we appreciate very much the courteous consideration you have extended to him.

I will not leave the statement, since Mr. Lanier presented our statement.

STATEMENT OF FLAKE SHAW, EXECUTIVE VICE PRESIDENT, THE FARM BUREAU

Mr. SHAW. Mr. Chairman, and gentlemen of the committee, this statement is filed on behalf of Mr. Carl T. Hicks, who is chairman of the Tobacco Cooperative Stabilization Corp. that serves the entire interests of the flue-cured growers. He could not be here.

I would like to make one point, Senator, if I may.

Senator BYRD. Yes, sir.

Mr. SHAW. The people who produce flue-cured tobacco have to contribute 400 man-hours to each acre of flue-cured tobacco that is grown. That is the most man labor that goes into the production of any commodity grown in this country.

There is one other point. The total acres of flue-cured is less than one-half of 1 percent of the total acreage of tobacco, cultivated acres, in the country. So we are working on an industry here, Senator, that is very small, with no possibility of being able to expand a great deal. I think that should carry some weight in the consideration of the program.

Senator BYRD. Thank you very much. We will receive the statement of Mr. Hicks which you have presented.

(The statement of Carl T. Hicks is as follows:)

STATEMENT OF CARL T. HICKS, CHAIRMAN, TOBACCO COMMITTEE, NORTH CAROLINA FARM BUREAU FEDERATION, AND PRESIDENT, FLUE-CURED TOBACCO COOPERATIVE STABILIZATION CORP., WALSTONBURG, N. C.

Mr. Chairman and gentlemen of the committee, my name is Carl T. Hicks. I am chairman of the tobacco committee of the North Carolina Farm Bureau Federation, an organization of 74,000 voluntary farm families, 70 percent of whom are growers of tobacco, either flue-cured or burely. I am also president of the Flue-Cured Tobacco Cooperative Stabilization Corp., serving farmers throughout the five flue-cured tobacco States. In 1950, there were 390,000 growers participating in this program.

I am here to plead against the proposal to increase the Federal excise tax against cigarettes.

There are nearly 2,000,000 tobacco farmers. There are thousands of processors who cure and pack tobacco. The welfare and survival of these many people is wholly dependent upon tobacco. Continued tax assaults against tobacco can only result in ultimate disaster to us. Already we are carrying a tax burden the likes of which is not shared by any other American product.

The amount of excise taxes from cigarettes now paid to the Federal Government alone is the largest paid by any American product except liquor. I apologize, Mr. Chairman, for the necessity of repetition on some of these statements, but we all think along the same lines.

The current excise tax of \$3.50 per 1,000 cigarettes amounts to 3½ times as much as the value added by manufacture, according to figures in the manufacturing census of 1947, published by the United States Department of Commerce. These same figures show that Federal cigarette taxes today represent an amount nearly three times as much as the tobacco farmer receives for his cigarette tobacco crop. Is not this evidence enough that tobacco is now bearing its share of the tax burden?

For the purpose of taxation, cigarettes are always classified as a luxury by those empowered to levy a tax against them. It hardly seems fair to classify as a luxury a product for which the American consuming public pays nearly \$5 billion annually. The Secretary of the Treasury definitely stamped cigarettes as an item of daily necessity in his statement before the House Ways and Means Committee on February 5, thus officially taking them out of the luxury class.

Besides the Federal tax on cigarettes, 41 States levy an additional tax averaging 3½ cents per package. Superimposed upon the Federal and State tax is still another levy by at least 100 municipalities throughout the Nation. The consumer, when purchasing his package of cigarettes today is faced with a tax burden ranging anywhere from 8 to 10 cents per package. In the face of this, how can you possibly justify an additional tax burden against cigarettes?

It is easy to pass off the responsibility in the matter by saying that eventually the tax is passed on to the consumer. If it were not in some measure passed on to the consumer, the cigarette industry would cease to exist, because the present Federal cigarette tax is equivalent to the amount received by the manufacturer for the packaged product before the tax is added.

The tobacco farmers are aware of the need for additional finances in the program of national defense. We are also aware of the fact that for more than a century, tobacco has been a consistent producer of vast revenues to the Federal Treasury. We welcome the opportunity to do our share in financing the Government. However, we feel that the interests of both the Government and the tobacco farmers will be best served if the consumer is encouraged to continue buying the finished product instead of being discouraged to continue its use, due to excessive taxation. We therefore urge this committee not to recommend an increase in the Federal excise tax now levied against cigarettes.

Senator BYRD. The Chair recognizes Senator Holland of Florida, to make a statement to the committee.

STATEMENT OF HON. SPESSARD L. HOLLAND, A UNITED STATES SENATOR FROM THE STATE OF FLORIDA

Senator HOLLAND. Thank you, Mr. Chairman, and member of the committee.

I appreciate this opportunity to appear briefly at this hearing on H. R. 4473 to strongly oppose the imposition of any added excise taxes on cigars, whether in the form proposed by the Secretary of the Treasury, or otherwise, and also to oppose the change in classification proposed by the Secretary.

I have been requested to appear by the cigar production workers of Tampa, Fla., and also by the Cigar Manufacturers Association of Tampa. I attach for the record telegram dated yesterday from Frank Diez, chairman, Tampa Cigar Makers Joint Advisory Board.

(The telegram referred to follows:)

TAMPA, FLA., *August 1, 1951.*

Hon. SPESSARD HOLLAND,
United States Senator, Senate Office Building,
Washington, D. C.:

On behalf of 4,000 organized Tampa cigar workers I strongly urge you to appear before the Senate Finance Committee and oppose any new tax on cigars. Any additional tax on cigars will reduce sales of cigars and kill Tampa's already sick cigar industry curtailing opportunity for employment of thousands of cigar workers.

FRANK DIEZ,
Chairman, Tampa Cigar Makers Joint Advisory Board.

Senator HOLLAND. The request from the manufacturers association came through Mr. Ray C. Brown, attorney for the association, and Mr. Francis M. Sack, its secretary.

Senator KERR. I would like to ask the distinguished Senator, if I may interrupt, to say that he has mentioned the name of a very great American. Ray Brown was contributed to Florida by the State of Oklahoma, and I must say that while you had a great gain there in that regard, we had an equal loss. The position of the Senator is enhanced by the fact that his statement here is backed up by such a distinguished citizen.

Senator HOLLAND. I thank the Senator from Oklahoma, and Florida is certainly happy to have Mr. Brown as one of its distinguished citizens.

Senator KERR. We have still got a hope that some of these days, when he has served enough of a term down there in your very fine State, that he will come back to Oklahoma.

Senator HOLLAND. We appreciate your position, but we do not share your hope.

Senator KERR. I can understand that.

Senator HOLLAND. In 1950 the 14 association factories in Tampa produced 231 million cigars. This was only 4.17 percent of the total output of the Nation, but it required the payment of excise taxes amounting to 7.33 percent of the total of Federal excise taxes paid. It thus appears that this segment of the Tampa cigar industry pays nearly twice as much in excise tax per cigar as is true for the cigar industry of the Nation as a whole. The reason for this is that a large proportion of the Tampa cigars are high-grade cigars and more than 100 million of them are cigars which are all hand-made. Tampa is the only remaining area in the Nation where cigars are made by hand for national distribution.

Of the 41,000 cigar production workers in the United States, Tampa has about 5,500 of whom between 3,000 and 4,000 are producers of all hand-made cigars and the rest are machine operators, or in other working classifications.

It is very clear to me from the record that what the cigar industry needs is a decrease of excise taxes and that an increase as proposed would be ruinous. I have carefully examined the able statement which is being filed today with the committee by Mr. Francis M. Sack and Mr. Ray C. Brown for the Cigar Manufacturers Association of Tampa. I have also carefully examined the able statement made by Mr. O. R. Strackbein before the Ways and Means Committee of the House of Representatives on March 12, 1951, in behalf of the Cigar Makers International Union.

I am glad to hear Mr. Strackbein will also file a statement before this committee.

I think it is completely clear from an examination of those two statements that the cigar industry is already carrying heavier taxes than it should bear, and that the taxes imposed in 1942 have operated to materially diminish the prosperity of the cigar industry, cut down the consumption of cigars and reduce the number of workers and producers.

In 1942 the total volume of cigars produced was 5,840,000,000 which was heavily reduced in the following years but has built back up gradually to 5,538,000,000.

In other words, it is still materially below the volume of 1942 and on a per-capita consumption is much more reduced than those total figures.

While every other industry of consequence in the Nation has been expanding its production including most of the other industries affected by excise taxation, the cigar industry has been staggering along under a heavier tax burden than it can bear. We deeply appreciated that the Ways and Means Committee of the House refused to increase the excise tax load of the cigar industry and sent the pending bill over without such an increase and we strongly hope that this able Finance Committee of the Senate will reach the same conclusion.

The impact upon Tampa of further blows at the prosperity of the cigar industry would be very grave indeed. Most of the workers are of middle age or over, and they simply could not adjust themselves to any new industry. They have lived in Tampa for many years, most of them throughout their lives, and most of them own their homes there. To throw them out employment now would be to put them on the welfare rolls.

The blow to the 5,500 cigar workers of Tampa would also constitute a major blow to the prosperity of the entire city and area of our State.

I firmly believe that the impact of an increase of excise taxes in the cigar industry is both unwise, inequitable, and destructive, and though I have mentioned specifically the effect in the Tampa area, I am sure that similar effects of varying degrees would be produced elsewhere in the Nation. The excise tax load on cigars has already reached the point of diminishing returns as shown by the collections for 1947, 1949, and 1950, for which years the figures of taxes collected were as follows: $47,100,000 in 1947; $43,500,000 in 1949; $42,700,000 in 1950.

There has been no better illustration in recent years of the truth of the statement by John Marshall, that the power to tax is the power to destroy.

I realize that the time factor today does not permit my making a more extended statement, and I will deeply appreciate the opportunity to appear before the committee in executive session after the hearings are closed.

Senator BYRD. Very well.

The next witness is Edward J. Regensburg.

STATEMENT OF EDWARD J. REGENSBURG, PRESIDENT, CIGAR MANUFACTURERS ASSOCIATION OF AMERICA, INC.

Mr. REGENSBURG. Mr. Chairman, and gentlemen of the Finance Committee, my name is Edward J. Regensburg and I am the vice president of E. Regensburg & Sons, Inc., manufacturers of cigars since 1867.

I appear here as president of the Cigar Manufacturers Association of America, a trade association, national in scope, and whose members manufacture in unit and dollar volume approximately 75 percent of the total United States production of cigars.

I should like to say at the outset that although ours is an industry steeped in the traditions and economy of this Nation, it is a small industry. The wholesale value of our product is less than $325 million annually. Dut to a number of causes, of which excise taxes is surely one, this industry has been unable to keep pace with the rest of our economy. Today the per capita consumption of cigars is not only less than it was in 1920, but also unit sales are only about 70 percent of what they were 30 years ago. Our profit on sales is less than 3 percent. It is almost unbelievable that our sales in each of the last 4 years have been less than they were in 1946, the first postwar year. They continue low and in the first 5 months of this year when dollar volume in other industries rose to the highest level in history, the cigar industry shows a fall in sales of almost 5 percent from the corresponding period in 1946.

Senator MILLIKIN. How much is the tax on a 10-cent cigar?

Mr. REGENSBURG. Exactly 10 percent on a 10-cent cigar.

Senator MILLIKIN. On a two-for-a-quarter cigar, how much is it?

Mr. REGENSBURG. Two for a quarter, it is in the same tax bracket. They have a bracket system.

Senator MILLIKIN. On a two-bit cigar?

Mr. REGENSBURG. It would be a little less than 10 per cent on a two-for-a-quarter cigar, and on a 15-cent cigar it would slope down.

But on a 10-cent cigar it figures exactly 10 percent.

In view of this decline in sales, it appears neither reasonable nor economic for the Secretary of the Treasury to be thinking at this time of adding to our present heavy tax burden.

In early 1950 we brought our situation to the attention of the Ways and Means Committee of the House. They were so impressed with the adverse conditions prevailing in the cigar industry that they recommended in the original revenue bill of June 1950, a reduction in cigar exese taxes of approximately one-third. This rate reduction, they said, was desirable in order to increase cigar sales relative to other tobacco products or at least aid the cigar industry in maintaining its present relative position.

We appeared again before the Ways and Means Committee this year pleading our inability to absorb a greater tax burden. When they voted against the imposition of any further cigar excise tax we experienced a sense of temporary relief. The Secretary of Treasury again singles out our industry for an increase in cigar excise taxes.

With minor exceptions, commodities scheduled for reduction in excise tax in the original revnue bill of 1950 are not now included for an increase.

We wish we were in a position, gentlemen, where we did not have to come to your committee and plead poverty, but the plain fact is that the cigar industry cannot afford any increase in its tax burden.

As a dramatic indication of the industry's condition, may I point out to you that for the first time in history, the Department of Agriculture has proclaimed marketing quotas on domestic cigar leaf tobaccos because the Secretary of Agriculture found that the cigar industry was not able to absorb the available supply of cigar leaf tobacco. Further to curtail our industry's potential sales volume would intensify the adverse condition in which the cigar leaf tobacco farmer now finds himself.

When Secretary Morgenthau appeared before this committee in 1942——

Senator MILLIKIN. Is your product a different product from the cigarettes?

Mr. REGENSBURG. It is in this respect; it uses different tobaccos, and it has no paper. It is all leaf tobacco.

Senator MILLIKIN. You fall in the classification of burley or flue-cured, or both, or what?

Mr. REGENSBURG. Very little burley or cured; very little burley or flue-cured tobacco is used in these cigars, except with certain low-priced cigars where they use it in the scrap blend.

But for the most part, our tobaccos are grown—I shall in a later part state where they are grown.

Senator MILLIKIN. I do not want to go into it now.

Mr. REGENSBURG. They are grown in a great many States, but they are cigar types of tobacco.

New York, Connecticut, Pennsylvania, Massachusetts, Georgia. I will go into that in a minute.

Senator MILLIKIN. I do not want to go into that now.

Mr. REGENSBURG. When Secretary Morgenthau appeared before this committee in 1942, requesting additional emergency wartime revenue, he stated that his proposal would yield an additional $13 million in revenue from the cigar industry. He, in effect, asked for a doubling of the tax rate on cigars bringing the anticipated total collections to $26 million.

We willingly consented to this doubling of the tax load, but pointed out that the method of taxation proposed by him was unadaptable to the characteristics of the cigar industry.

What happened was that instead of doubling the cigar industry's tax load as an emergency wartime measure, it has more than tripled the industry's tax load during each of the postwar years. We have all these years, and still are, staggering under this emergency wartime tax load.

The Secretary of the Treasury now asks for an additional $25 million annually on top of a tax load already too high. His recommendation would not only nullify the Ways and Means Committee's recognition of our problem, but would so reduce our sales that we feel no additional revenue at all would be produced.

I cannot emphasize too strongly the error of an assumption that cigar sales would continue without decrease in unit and dollar volume in the event that taxes are upped even slightly. For every 1 percent increase in the tax rate the total cigar volume will decline in millions of units. Therefore the proposed increase, which effectually will double our present rates, will not produce the revenue contemplated, but would destroy capital investment in plants, jobs, for cigar workers, and the livelihood for other cigar leaf farmers.

Please allow me briefly to touch upon the inequities of the Secretary of the Treasury's proposal as it now stands.

It would result in extremely uneven tax increases. For example, the 6-cent cigar would suffer a 140-percent increase in tax while the 10-cent cigar would be increased by 50 percent.

Similar discrepancies can be found throughout the schedule. The uneven tax increases would necessitate uneven price adjustments. There would ensue marketing distortions with corresponding harmful effect competitively on the manufacturers, wholesalers, and retail dealers.

The same erroneous thinking that hurt our industry in the past applies to the present proposal. The Secretary has estimated that his proposal would produce $25 million more revenue from our industry. I respectively point out that this is a mistake, and that the practical application of the Secretary's proposal would penalize our industry to the extent of $35 million or more, providing unit sales volume remains the same. That sales volume would remain the same is an assumption which is false, erroneous, and will not be borne out by any competent market research.

As I stated before, our industry is steeped in the traditions of our Nation. Though small in comparison with our great industries, nevertheless it is important to the hundreds of thousands who are directly or indirectly dependent upon it for their livelihood.

The welfare of thousands of cigar tobacco farmers in the States of New York, Connecticut, Pennsylvania, Massachusetts, Florida, Georgia, Wisconsin, Ohio, Minnesota, North Carolina, Tennessee, Kentucky, Virginia, Maryland, West Virginia, and Missouri, and their hundred-thousand-odd acres of tillable land with investments of upwards of $75 million; the forty-odd thousand workers in cigar factories; the thousands of distributors and the hundreds of thousands of independent retail tobacco merchants, not to mention the thousands of cigar manufacturers, hinges upon this committee's rejection of this improvident tax proposal.

I have been asked by the National Association of Tobacco Distributors to submit a brief in support of the statement I have just made in behalf of the industry. I am also submitting a brief of the Cigar Manufacturers Association of America which I would like to have entered into the record of this hearing.

May I have your permission to file before Tuesday of next week supporting statements by the Cigar Manufacturers Association of Tampa, Cigar Makers International Union of America, AFL, the Lancaster Tobacco Board of Trade, the New York Leaf Tobacco Board of Trade, the Georgia-Florida Tobacco Growers Association, the Pennsylvania Tobacco Growers Association, Connecticut Valley Shade Grown Tobacco Association, and the Retail Tobacco Dealers Association of America, these to be made part of this record.

Senator BYRD. Very well.

Thank you very much.

Mr. REGENSBURG. Thank you, gentlemen.

(The documents referred to above and a statement of O. R. Strackbein in lieu of an appearance are as follows:)

MEMORANDUM SUBMITTED BY THE NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS IN OPPOSITION TO ANY INCREASE IN TAXATION UPON CIGARS

This memorandum is submitted by the National Association of Tobacco Distributors, representing the wholesale tobacco trade throughout the United States, and whose membership is engaged in the distribution of cigars to more than a million retail outlets. The wholesale tobacco trade is keenly concerned with the economic well-being of the cigar industry because of the declining character of cigar consumption which is due primarily to (*a*) a sharp diminution of cigar consumers and (*b*) to the fact that the present excises on cigars are so heavy that they are a millstone around the neck of the industry.

At present, cigars are offered and sold at prices which militate against any expansion of this static industry, and to levy heavier taxes on cigars would be tantamount to crucifying an already retrogressive industry. The sharp drop in cigar consumption since 1920 is a matter of statistical record. Although the population increase between 1920 and 1950 was 23.5 percent, the unit production of cigars in the same period declined approximately 31 percent, and the per capita consumption fell off from 77 cigars in 1920 to 38 cigars in 1950. As a consequence, economic roadblocks have been placed in the paths of several thousand wholesalers and more than a million retailers.

Traditionally, cigars—in addition to providing a reasonable yield on sales—have also served as a sort of yardstick in measuring the standing of wholesaler and retailer. Their status in the community and commercial world has been largely influenced by the brands and assortment of cigars they carried and handled. In the instance of the wholesaler, the size of his sales staff, the frequency of trade canvassing, his credit policy, and his mercantile standing were largely governed and influenced by his cigar business.

In recent years, owing to the decline of cigar consumption, caused mainly by a burdensome tax schedule, coupled with a change of public smoking habits, a complete change in the wholesale distributor's mode of operation has been necessitated. To survive in business he was obliged to diversify his lines and devote more attention to other products, thereby even further handicapping the struggling cigar industry.

As it pertains to the customer of the wholesaler, the retail merchant, his traditional cigar case has been shrinking in size and the space formerly allocated to cigars has been turned over to other products. These factors, born of economic necessity, have further conspired to throttle the cigar industry, with the consequence that even fewer cigars are being sold and the tax yield to the Government has declined in similar proportion.

In the dynamic processes which stimulate the growth of America, a number of industries are submerged or eclipsed. This may be ascribed to the inability to gear or attune the industry to the exactitudes of the assembly lines or machine production. Until such industries can evolve a method of adapting their operations to the economics wrought by modern technological inventions, they should be aided and not injured. The cigar industry happens to be in that unfortunate category.

It was not so many years ago that all cigars were hand-made. The industry is still in the process of transferring to machine operation. The generic nature of the product renders such transition exceedingly slow and tortuous. With the present high cost of living, the average consumer can ill afford to pay even the present high prices for cigars, and a higher price—which would be necessitated by an increase in the tax schedule—would inevitably further reduce cigar consumption.

We believe that the best interests of Government, the public, the more than a million retailers, and the several thousand wholesalers would actually be much better served by reducing the tax on cigars and thereby provide an opportunity for the industry to get back on its feet. The static nature of the cigar industry has tended to weaken the economic fabric of the wholesalers and retailers, and that is utterly unhealthy for America and the American way of life.

We join the Cigar Manufacturers Association in pleading for the exclusion of cigars from any heavier taxation and thereby aid in the reactivation and revitalization of a basic American industry.

STATEMENT SUBMITTED ON BEHALF OF THE CIGAR INDUSTRY BY THE CIGAR MANUFACTURERS ASSOCIATION OF AMERICA, INC., NEW YORK, N. Y.

This association comprises cigar manufacturers located in all cigar manufacturing centers of the United States who produce collectively in excess of 75 percent of the total unit and dollar volume of cigars. Its members include small, medium-sized and large firms making cigars retailing at prices in all seven of the present revenue classes. This association is the only national association of cigar manufacturers and is truly representative of the entire cigar industry.

I

The cigar industry is unalterably opposed to the proposal of the Secretary of the Treasury which seeks a further increase in cigar excise taxes. It opposes both an increase in cigar taxes and the method of revising the tax brackets, because—

(1) Conditions in the cigar industry have deteriorated since the time when the present cigar excise tax schedule was imposed and sales have declined continuously since 1946, the end of World War II.

(2) Economic changes have occurred since June 1950, when the House voted a 30 percent reduction in cigar excise taxes, which impair the cigar industry's profit margins.

(3) Of the many commodities for which a reduction in excise taxes was proposed in H. R. 8920 (81st Cong.), cigars almost alone are now singled out by the Secretary of the Treasury for an increase.

(4) The cigar industry is still paying a wartime emergency tax.

(5) The bracket system proposed by the Secretary of the Treasury imposes unequal burdens on competitively priced cigars.

II

When the Ways and Means Committee recommended a reduction in cigar excise taxes last June, it said in its report:

"Cigar sales have fallen off rapidly in the last few years, and it is anticipated that the rate reduction provided for cigars in your committee's bill will increase

cigar sales relative to other tobacco products or at least aid the cigar industry in maintaining its present relative position."

Cigar sales have declined continuously since 1946, the first postwar year. Moreover, in spite of business activity in the first 5 months of 1951, cigar sales are still 5 percent lower than in the corresponding period of 1946.

Consumer resistance to present cigar prices is still manifest in that the average retail price of cigars in 1950 was lower than in 1946. Cigar retail prices, as well as wholesale prices, have been raised very moderately, if at all, since the termination of the Office of Price Administration in 1946.

Since June 1950, when the House voted a reduction in our tax, cost of leaf tobacco and labor have risen sharply. Both are major factors in the cost of making cigars. Leaf-tobacco costs will undoubtedly rise further, particularly domestic tobaccos which are not under price ceiling (because of the parity adjustment provisions in the Defense Production Act). In addition to these basic costs, cost of supplies, transportation, and distribution have risen substantially. The cigar industry has absorbed, practically in their entirety, these increased costs because of consumer resistance to current cigar prices.

As a result, profit margins in the cigar industry have been substantially impaired and the imposition of a tax increase would so imperil the industry as to force many small and medium-sized firms to liquidate.

III

The Secretary of the Treasury's proposal puts the Government and the cigar industry on the horns of a dilemma. When the Anderson Act became law in 1950, the parity price on cigar leaf tobacco was raised to a greater degree than any other agricultural commodity. Under this law parity prices on most types of cigar leaf tobacco are approximately 80 percent higher than they would have been under the original Agricultural Adjustment Act formula. The full impact of this increase in parity price has not yet been measured.

The cigar industry did not oppose this change in the parity formula because it was fully cognizant of the necessity of maintaining the stability of the agricultural segment of the Nation's economy. On the other hand, the Government's price support to the tobacco farmer will become an empty gesture if the cigar industry is unable to process leaf tobacco and market the finished product.

For the first time in history, the Secretary of Agriculture proclaimed marketing quotas on cigar leaf tobaccos—he having found that the supply of these tobaccos exceeded demand.

Any increase in the tax burden of the cigar industry will undoubtedly result in a decline in cigar sales with a concomitant shrinkage in both farmers' income and Government revenue, thus defeating the desired ends of both the Department of Agriculture and the Treasury Department.

IV

A further increase in cigar prices will undoubtedly meet further consumer resistance. The proposal of the Secretary of the Treasury would necessitate an average price increase of about 7 percent on the retail price of cigars; this is more than twice the cigar industry's net profit margin in 1950. It is self-evident that such a tax increase can only result in irreparable injury to the industry.

With minor exceptions, the Secretary of the Treasury proposes no increase on any commodity as to which the House voted a decrease in the original 1950 revenue bill (H. R. 8920). No increase is recommended by him for snuff, plug, and twist chewing tobacco whose economic status is no worse than that of the cigar industry.

To single out cigars (which shows no improvement in its economic status) for an increase in tax from all other commodities scheduled in June 1950 for a reduction in tax, is discriminatory, unjust, and oppressive.

V

For many years the cigar industry has suffered under the yoke of the 1942 wartime emergency tax burden. It has paid, as a result of a mathematical error made in 1942 by the then Secretary of the Treasury, twice as much of an increase in tax revenue as sought. The then Secretary of the Treasury, in seeking this increase, termed it an "emergency tax."

The cigar industry did not oppose that increase because it was willing to bear its share of the war burden. It did, however, point out the inaccuracy of the Secretary's estimate and made recommendations which would have avoided the difficulties under which the cigar industry has labored ever since. The cigar industry is still paying at the 1942 wartime tax level.

The present Secretary of the Treasury now proposes another emergency tax, the effect of which would be to add an emergency tax upon an emergency tax. Moreover, not only would the present Secretary of the Treasury perpetuate the error committed in 1942, but would compound that error with another error.

In 1942 the Secretary of the Treasury estimated that his proposed cigar excise tax schedule would add increased revenue from the cigar industry at the rate of $13 million per annum; in fact, it has added increased revenue in excess of $25 million per annum.

The present Secretary of the Treasury estimates that his proposal will add another $25 million tax to the cigar industry's present annual tax load. The Secretary's estimate is based on the assumption that unit sales will continue at present levels. Stated otherwise, the Secretary of the Treasury assumes either that cigar manufacturers will and can absorb the entire increased tax burden, or that the increased tax can be passed on in its entirety to the consumer.

Even assuming, without conceding its accuracy, that cigar sales would continue at present unit levels, an increase in the tax burden must necessarily result in an increase in the price of the cigar. In practically every instance, the Secretary of the Treasury's proposal necessitates an increase in the retail price of the cigar, throwing it into a higher price bracket. The higher the tax bracket, the higher the tax under the Secretary's proposal. Based on his erroneous assumption, instead of an increase of $25 million per annum in revenue, the Secretary's proposal would yield approximately $35 million per annum in additional revenue.

We completely reject the assumption that his proposal would result in additional revenue to the Government, but respectfully submit that it would be so burdensome upon the cigar industry as to cause diminishing returns through the crippling of an already depressed industry.

VI

The Secretary of the Treasury's proposal as it now stands would cause great inequities in the incidence of the tax increases. For example, the 6-cent cigar would suffer a 140-percent increase in tax while the 10-cent cigar would be increased by 50 percent. Similar discrepancies can be found throughout the schedule. The uneven tax increases would necessitate uneven price adjustments. There would ensue marketing distortions with corresponding harmful effect competitively on the manufacturers affected.

The same erroneous thinking that hurt our industry in the past applies to the present proposal. The Secretary has estimated that his proposal would produce $25 million more revenue from our industry. It is respectfully pointed out that this is a mistake and that the practical application of the Secretary's proposal would penalize our industry to the extent of $35 million or more, providing unit sales volume remains the same. This is an assumption which is false and erroneous.

It is therefore urged that the Secretary of the Treasury's schedule be rejected as being utterly incompatible with the competitive price groupings which the cigar industry has found essential to the marketing of its product.

VII

In conclusion, it is respectfully submitted that (1) in the light of declining cigar volume, (2) consumer resistance to present cigar prices, and (3) rising leaf tobacco, labor, and materials costs, any increase in the cigar industry's tax burden will jeopardize the welfare of the thousands of farmers who produce cigar leaf tobacco, and the thousands and thousands of workers employed directly and indirectly by and in the cigar industry.

The bracket system proposed by the Secretary is completely incompatible with present pricing practices and is highly discriminatory.

For all of the foregoing reasons, we urge that the proposal of the Secretary of the Treasury for an increase in the cigar industry's tax rate be rejected in its entirety.

Respectfully submitted.

CIGAR MANUFACTURERS ASSOCIATION OF AMERICA, INC.,
By EDWARD J. REGENSBURG, *President*.
BLUMBERG, MILLER, SINGER & HEPPEN,
General Counsel.
By LEON SINGER.

STATEMENT OF O. R. STRACKBEIN, REPRESENTING THE CIGAR MAKERS INTERNATIONAL UNION

The Cigar Makers International Union, an affiliate of the American Federation of Labor, is vitally interested in the future of the cigar industry of this country. Anything that adversely affects the cigar industry affects the welfare of our membership.

The proposed increase in the tax rates on cigars would, in our judgment, injure the cigar industry by either reducing the consumption of cigars or preventing the expansion of the industry in keeping with the growth of our population and the general expansion of our economy.

As is well known, the cigar industry has for 30 years struggled for its existence, against what, nearly 20 years ago, appeared as a sure demise. The employees have borne the brunt of this struggle above all others. One phase of their difficulty lay in the advance of the automatic machine, the progressive introduction of which displaced many thousands of cigar makers. By contrast, many companies were able to save themselves by the very process of displacing hand workers by machines; but this did not save the cigar makers who became surplus manpower under the circumstances.

Today we join the cigar manufacturers in calling attention to the further danger to this industry contained in the sharp increase in taxes now proposed. Our interests are fully as vital as those of our employers and in this instance our concern is mutual.

Conceding, as we must, the need of increased revenue by the Government, we respectfully suggest that the proposed new rates on cigars are exorbitant and would result in but little more revenue while crippling the cigar industry. Whereas the industry has barely survived the change in smoking habits of the public during the past 20 years, and while it was not destroyed by the increased tax rates of 1942, it is clear that the industry is bearing about all that it can in the continuing race for survival. To increase its handicap materially at this time would be an act that could turn the tide against any hopes of the industry for a healthy future.

Thirty years ago—i. e., in 1921—the production of cigars in this country amounted to 6,726,000,000. The population of the United States at that time was 105,710,000. In 1950, cigar production amounted to 5,538,000,000; i. e., over a billion fewer cigars than in 1921. The population in the meantime had increased to approximately 115,000,000. In other words, consumption of cigars declined from 63.6 cigars per capita in 1921 to approximately 37 cigars in 1950.

We do not suggest that this decline was the result of high taxes. We merely note the downward sweep as a fact and as one mark of the unhappy conditions through which the industry has passed. Employment in the industry has suffered even more of a shrinkage since 1921 than has cigar production. According to the United States census of manufactures, 119,000 wage earners were employed in the cigar industry in 1921. In 1937, employment was 55,787 or somewhat less than half the 1921 figures. In 1950, the number employed was lower still, or about 40,000, having in March of 1950 dropped as low as 38,800, according to figures released by the Bureau of Labor Statistics. In other words, employment in 1950 had dropped to about one-third of the 1921 figure.

In summary, production of cigars from 1921 to 1950 declined 17.7 percent, while population increased 43 percent. Per capita consumption of cigars during the same period declined approximately 42 percent. By contrast, employment declined 66.5 percent or about two-thirds.

The following table will show these trends in statistical form:

	Cigar production	Percent decline from 1921	Per capita consumption	Percent decline from 1921	Number of workers	Percent decline from 1921
Year 1921	6,726,000,000		63.6 cigars		119,000	
Year 1933	4,300,000,000	36.1	34.2 cigars	46.2	54,600	54.1
Year 1937	5,310,000,000	21.0	41.2 cigars	35.2	55,789	53.1
Year 1950	5,530,000,000	17.7	36.7 cigars	42.3	41,000	66.4

NOTE.—Population estimates of the United States by Bureau of the Census, published in the Statistical Abstract of the United States, 1949, p. 7, are: 1921, 108,541,000; 1933, 125,579,000; 1937, 128,825,000; 1950, 150,697,000.

These figures are but an abstract reflection of a story of hardship, distress, and despair for thousands of people—of warm-blooded people, of aging people, of Americans. They were beset by relentless economic forces that ground all rekindling hopes to pieces as the years passed. In the midst of the downward grind came the distressful depression of the early years of the 1930–40 decade. Combined with the encroaching advancement of the cigar-making machine, the outlook for the employees became gloomier than ever. Cigar production fell to a low of 4,300,000,000 cigars in 1933. These were mostly cigars that retailed for 5 cents each or less, classified in the lowest revenue value bracket or class A.

Thereafter a slow revival set in, and by 1937 production had reached a total of 5,317,000,000 cigars. Since that time output has remained above the 5-billion-per-year level but has never again reached 6 billion cigars in any one 12-month period.

In 1942 the tax rate on cigars was increased to the present level and annual production has in no year since that time regained the level of that year, which was the highest since 1930, or 5.84 billion cigars. The following table tells the story:

[In billions of cigars]

Year	Production	Year	Production
1929	6.52	1941	5.61
1930	5.89	1942	5.84
1931	5.34	1943	5.36
1933	4.30	1944	5.19
1935	4.76	1945	5.27
1937	5.31	1947	5.48
1939	5.19	1949	5.58
1940	5.23	1950	5.53

While it is difficult to determine the exact percentage of increase in the tax rates of 1942 over the rates which they superseded, an approximation of the increased burden can be attained by comparing the internal revenue collections before and after 1942. By comparing the average annual tax collections per 1,000 cigars before and after 1942, the changing burden upon the industry will be reflected. The next table will show this change in the average tax burden per 1,000 cigars:

Year	Production (thousands of cigars)	Taxes collected	Amount of tax per 1,000 cigars
1939	5,197,627	$12,800,000	$2.45
1940	5,235,271	13,000,000	2.48
1941	5,610,176	14,000,000	2.49
1942	5,840,805	16,800,000	2.87
1943	5,363,027	27,600,000	5.14
1944	5,196,679	33,500,000	6.44
1945	5,274,675	38,100,000	7.22
1947	5,487,656	47,100,000	8.58
1949	5,586,768	43,500,000	7.78
1950	5,538,152	42,700,000	7.71

Other products on which internal taxes have been collected have, by contrast with the cigar industry, enjoyed a healthy expansion since 1942. The next tables show the upward trends of these products:

Product	Production				
	1942	1945	1947	1949	1950
Fermented malt liquor..............million barrels..	63.7	86.6	87.8	89.7	88.8
Distilled spirits....................million gallons..	157.9	128.2	316.1	266.5	208.2
Still wines..................................do....	313.7	314.9	515.3	425.9	297.8
Cigarettes..............................billions..	257.5	332.1	369.8	384.9	[1] 391.9

[1] Preliminary.

The striking difference between the production trend in these products since 1942 and the trend in cigar production is easily observed. Without exception the production of the listed products has expanded substantially whereas cigar production has declined.

Here, in the case of cigars, is a good example of saturation taxation or the point of diminishing returns.

Although the characteristic economy of the United States (as illustrated in the foregoing table) has been one of increasing production in the past 10 years, the cigar industry has done little better than hold its own. It did increase from 1939 to 1942 but declined after the increase in the tax rates went into effect.

To be sure, the Treasury did collect a large revenue after 1943 on cigars—in fact, more than tripled its collections—but the blighting and stagnating effects of heavy taxation could hardly be demonstrated more clearly than in this case.

Thus in 1942, with the first opportunity of revival and at the first signs of growing with the expanding business of the country and its industrial activity, after two or three decades of almost unrelieved discouragement, the cigar industry and its cigarmakers felt the heavy hand of taxation laying its restraining grip upon their shoulders. The uptrend in cigar production was not only halted in its tracks but reversed.

But that was not enough.

Today we find another drastic tax increase proposed by the Treasury Department. Before the industry has recovered the ground lost since 1942, it is asked to carry a still heavier burden. The retail prices of cigars, already very high, would be forced higher still; and consumption unquestionably would decline. Again, the Government might collect more revenue. It would indeed do so unless the decline in consumption should carry the volume of cigars well below the 5,000,000,000 mark.

The question, however, arises whether it is sound and wise tax policy that leads to a higher revenue collection at so high a cost to production, employment, and consumption. We do not believe that it is, nor can we convince ourselves that the Treasury Department subscribes to such a policy. We prefer to believe that their calculations have erred out of a failure to assess fully the effects of the 1942 increase in rates on cigar production and consumption, and that this error led the Department to a lack of appreciation of the crushing impact that the yet higher rates now proposed would produce.

We again call attention to the difference in the production trend between cigars on the one hand and other products on which similar taxes are levied, since 1942, as reflected in tables previously presented herein, on the other.

The Treasury has estimated that the proposed new rates would result in the collection of an additional $25,000,000 per year from the cigar industry. This would mean increasing the present burden by more than 50 percent. Collections in 1949 amounted to $43.5 million and in 1950 to $42.7 million. This is an average of $43.1 million per year. An increase of $25 million over $43 million would bring the annual burden to $68 million, an increase of approximately 60 percent over the average burden of the past 2 years.

In view of the record of the cigar industry since 1942, especially as it contrasts with the general economic trend, it seems incredible that a 60-percent increase in the tax burden would be proposed now. Every indicator, on the contrary, points to the conclusion that the existing rates are already too high and that the increase of 1942 was excessive. If all tax rates had begotten the results of the increased tax rates on cigars, our postwar economy, instead of expanding, would have stood still or receded. Such results would have condemned the tax measures that brought them about, just as they should condemn the 1942 increase in the rates on cigars.

There is an ostensible decrease in the lower levels of the proposed tax rate, brought about by reducing the rates on the cheapest cigars. Since, however, few cheap cigars are manufactured, this proposed rate reduction would be meaningless. Below are shown the 1926-42 rates, the rates enacted in 1942, and the proposed rates:

	Tax rate per thousand
1926 rates:	
Class A (not over 5 cents each)	$2.00
Class B (over 5 cents, not over 8 cents each)	3.00
Class C (over 8 cents, not over 15 cents each)	5.00
Class D (over 15 cents, not over 20 cents each)	10.50
Class E (over 20 cents each)	13.50
1942 rates:	
Class A (2½ cents each or less)	2.50
Class B (over 2½ cents, not over 4 cents each)	3.00
Class C (over 4 cents, not over 6 cents each)	4.00
Class D (over 6 cents, not over 8 cents each)	7.00
Class E (over 8 cents, not over 15 cents each)	10.00
Class F (over 15 cents, not over 20 cents each)	15.00
Class G (over 20 cents each)	20.00
Proposed rates:	
Class A (not over 2 cents each)	1.50
Class B (over 2 cents, not over 4 cents each)	3.50
Class C (over 4 cents, not over 6 cents each)	6.50
Class D (over 6 cents, not over 8 cents each)	9.75
Class E (over 8 cents, not over 10 cents each)	12.75
Class F (over 10 cents, not over 12 cents each)	15.75
Class G (over 12 cents, not over 14 cents each)	18.75
Class H (over 14 cents, not over 16 cents each)	21.75
Class I (over 16 cents, not over 18 cents each)	24.75
Class J (over 18 cents, not over 20 cents each)	27.75
Class K (over 20 cents each)	37.50

Today the production of cigars in the lower classifications is relatively small. The trend toward cheap cigars became marked after 1921. In that year, 30.2 percent of all cigars fell into class A. By 1929 the portion had risen to 54.0 percent; by 1933, to 84.9 percent; and by 1935, to 87.5 percent. This included the 5-cent cigar. The trend was reversed after the outbreak of World War II.

In 1950, cigars selling at 4 cents each or less represented only 4.1 percent of total tax-paid withdrawals, as indicated by the sale of internal revenue stamps. Cigars retailing at more than 6 cents each but not over 15 cents represented 57.4 percent of total withdrawals. Those selling at more than 4 cents but not over 6 cents accounted for 38.2 percent of all withdrawals. Thus the great predominance of the cigars selling at 5 cents or less each has disappeared. Nearly half of the total in 1950 were cigars selling from 8 to 15 cents each (or 47.1 percent).

The present rate on cigars in this price range is $10 per thousand (class E). The proposed rates range from $12.75 to $21.75 per thousand (classes E through H) on cigars of virtually same price range (the proposed class H carries through 16 cents each).

The effect of the proposed tax would be to drive many cigars into the next higher bracket with its higher tax rate. Should the present 10-cent cigar be driven into the next bracket—i. e., into class F of the proposed schedule—the tax rate would increase from the present rate of $10 per thousand to $15.75 per thousand or by $5.75 per thousand. If this were resisted, the cigar industry, from leaf-tobacco producers through cigar maker, manufacturer, jobber, and retailer, would have to absorb the $2.75 per thousand increase in the tax. Should the retail price be raised from 10 cents to 11 cents, the tax rate would go from $10 to $15.75, as stated above, instead of merely to $12.75, which would be the new rate on a 10-cent cigar. There would therefore be a penalty of $3 per thousand against passing even a fraction of the increased tax on to the consumer. A similar penalty would be incurred in passing from a lower to a higher bracket.

For example, the 6-cent cigar today pays a tax of $4 per thousand. The new tax would be $6.50 or an increase of $2.50 per thousand. Should this additional burden of $2.50 per thousand force the 6-cent cigar into the 7-cent retail bracket, the new tax would be not $9.50 per thousand but $9.75, since the 7-cent price would lift the cigar into the next higher class (into class D of the proposed rates). This would represent an increase of 143.75 percent (i. e., from the present $4 per thousand to $9.75 per thousand) instead of the apparent increase from $4 to $9.50, which would be an increase of 92.5 percent.

CONCLUSION

All the foregoing: The decline of cigar production since 1942, a trend in reverse of the general one of the economy as a whole; the magnitude of the increase now proposed, both in the total burden and in particular rates; the penalty against passing on to the consumer any of the increased tax on cigars now retailing at the top level of existing price brackets, as just described — these considerations as well as other economic factors mentioned herein unite to characterize the newly proposed tax as violative of the sound principles of taxation and as crossing the dividing line that separates sound taxes from oppressive ones.

We therefore urge this committee not to approve the proposed increase in taxes on cigars. No minor change from the proposed new tax schedule as set forth above would alter the merits of the case.

Senator BYRD. Mr. Horney.

STATEMENT OF LEO G. HORNEY, ASSISTANT TO THE GENERAL MANAGER OF BENDIX AVIATION CORP.

Mr. HORNEY. My name is Leo G. Horney. I am assistant to the general manager of the Bendix radio division of Bendix Aviation Corp. in Baltimore, Md.

I am also full-time counsel to the Bendix radio division. My company appreciates the opportunity which has been given me to appear before your committee to suggest modifications to section 482 of H. R. 4473, which section amends section 3404 of the Internal Revenue Code.

Section 482 would exempt sales to the United States of certain radio-receiving equipment and component parts thereof but the term "radio receiving set" is still left undefined. We subscribe fully to the action of the House in giving voice to this exemption feature for reasons which have already been made known to the committee of that body. However, it is our belief that the exemption should be broadened so as to include all of the devices and component parts thereof which are exempt when sold to the United States, so that the exemption applies when such devices and component parts thereof are sold to commercial or other nongovernmental enterprises.

We seek these modifications to the end that in the application of the tax there should certainly be (1) as to liability and amount of the tax in advance of the taxable sale; (2) that the tax might be imposed uniformly and without discrimination; (3) that the statute might be subsequenly enacted in a form which will present the least possible number of difficult administrative problems; and (4) that radio and communication devices in many instances required by law for the safety and welfare of those being served, can in no way be considered as luxury or entertainment items and, therefore, should not be taxed.

The chief difficulty in complying with and in administering section 3404 as presently written and as proposed in section 482 of the present bill lies in the fact that the words "radio receiving set" are not sufficiently defined in the law.

We believe that it was the original intent of Congress, as expressed in the 1932 statute, to tax only radio receiving sets of the type you and I have in our homes or in our cars and which are used for entertainment purposes.

We understand that the Treasury people who are involved in the specific administration of this law hold the same belief, but since the words "radio receiving set" are susceptible of a much broader meaning, they felt compelled, due to the lack of a legal definition, to construe those words broadly enough to include all radio receivers which produced sound, and I repeat, "sound."

Thus they have taxed such receivers as those used on airplanes for communication with airports and those used on trains for dispatching purposes. They have also taxed receivers used solely for the reception of the dots and dashes of the Morse code so long as an operator hears the dots and dashes. If, however, the dots and dashes are used to punch holes in a paper tape which is later deciphered, they have held that such a receiver is not taxable since it does not produce sound.

This obviously arbitrary definition is in no way a reflection upon the ability of the Treasury Department since they were put in the unenviable position of having to arrive at a compromise solution which lay somewhere between what they felt to be congressional intent and the actual engineering dictionary meaning of the words.

An engineer defines a radio receiving set as a device which intercepts electromagnetic waves radiated through space and transforms these signals into some useful effect.

It is generally a fact in the industry, and specifically so with respect to that portion of the industry which our own company represents, that many of the devices of an electronic nature which are sold to the United States, and which are enumerated under section 482, are sold in their identical form to nongovernmental users such as railroads, airlines, marine operators, and various utilities.

The use of communication, navigation, and detection devices by these private and semiprivate enterprises is as essential as the very functioning of the activities themselves. At the same time, while Congress has seen fit through subsidies, preferential tax treatment, and other actions to be of assistance to such users, there has been no specific action taken in the direction of relieving them of their payment of an excise tax on their purchase of such necessary augmenting devices, notwithstanding the fact that the total annual gross tax revenue from such sources is microscopically insignificant.

We are working in a no man's land between the letter of the law and the clear intent of the Congress. It is our desire to have the letter of the law merely conformed to the intent of Congress.

The manufacturers and the Bureau of Internal Revenue have struggled with several definitions of a radio receiving set in an effort to establish at the point of sale the taxability and the amount of tax in any given situation.

In 1932 and subsequently Congress clearly intended that taxability of a device under section 3404 of the Internal Revenue Code should be confined solely to the reception of "entertainment sound," that is to say, the universally known entertainment-type radio receiving set. Actually it was intended to levy a luxury tax, imposed at the point of manufacture for ease of collection.

By way of simple illustration and as a means of further clarification of the foregoing statements, we recognize that much of the radio equipment produced by our company and by our associates in the industry is composed of combination receivers and transmitters housed within a single package, the separation of which in terms of functional ability being known only to the most capable electronics engineer.

It is a device of this nature which the manufacturer is called upon constantly to examine and to make his own determination of which portion or portions of the device is taxable and to what extent.

Since he is guided by no formula, he and his industry associates are left to make their own determinations to their own detriment or to the possible detriment of the Government, and with the possible imposition of tax liability upon himself should he err in his tax determination, since each manufacturer must obtain his own rulings as none are officially published by the Treasury Department.

Since his only means of securing some degree of protection is through the submission of requests for specific rulings, each of which consumes from 1 week to 12 months in its resolution, it appears that the solution to the problem is to make modifications to section 482 so as to delete therefrom all equipment of the type whose function is that of communications, navigation, and detection when sold to the United States Government and to commercial enterprises.

This can be accomplished by any one of several very simple methods. Attached to this statement for the record are two possible methods of accomplishing this purpose. One of these involves changes in section 482 of H. R. 4473. The other proposes revision of section 3404 so as to impose the tax only on the entertainment-type radio and television receiving sets, excluding commercial equipment which would be consistent with the application of tax to other applications.

This is not a revenue problem. A recent study indicated that the revenue from the taxation of commercial types of electronics receiving equipment averages about $50,000 a month. It is our firm belief that the taxpayers' cost for compliance and enforcement costs to the Bureau of Internal Revenue undoubtedly exceeds 50 percent of the total revenues produced from this source.

Senator BYRD. Thank you very much.

(The material referred to in Mr. Horney's statement follows:)

ALTERNATIVE No. 1

DEFINITION OF RADIO AND TELEVISION RECEIVING SETS

(a) DEFINITION OF SETS.—Section 3404 (a) (relating to manufacturers' excise tax on radio receiving sets, etc.) is hereby amended to read as follows:

"Radio receiving sets, television receiving sets, phonographs, combinations of any of the foregoing, of the household, portable, automobile, or other amusement type."

(b) DEFINITION OF COMPONENTS.—Section 3404 (b) (relating to manufacturers' excise tax on certain components of radio receiving sets, etc.) is hereby amended to read as follows:

"Chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the built-in type, and phonograph mechanisms (hereinafter referred to as 'radio components') for, or suitable for use as parts of or with, any of the articles enumerated in subsection (a), except when sold as component parts of a complete radio receiving set, television receiving set, phonograph, any combination of the foregoing, or other electronic apparatus. Under regulations prescribed by the Secretary, the tax under this subsection shall not apply in the case of sales of any such radio components by the manufacturer, producer, or importer to a manufacturer or producer of radio receiving sets, television receiving sets, phonographs, any combinations of the foregoing, or other electronic apparatus. If any such radio components are resold by such vendee otherwise than on or in connection with, or with the sale of, complete radio receiving sets, television receiving sets, phonographs, any combinations of the foregoing, or other electronic apparatus, manufactured or produced by such vendee, then for the purposes of this section the vendee shall be considered the manufacturer or producer of the radio components so resold."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall take effect on the first day of the first month which begins more than 10 days after the date of the Act, except that the related tax imposed by section 3444 (b) (on use by the manufacturer of taxable components) shall not apply to the use of components formerly included under section 3404 (b) when contained in articles sold on and after the first day of the first month which begins more than 10 days after the date of the enactment of this Act. Refund or credit shall be allowed with respect to tax paid or incurred thereunder.

ALTERNATIVE NO. 2

SEC. 482. NAVIGATION RECEIVERS [~~SOLD TO THE UNITED STATES~~]

(a) EXEMPTION ON SALES [~~TO UNITED STATES~~ OF CERTAIN RADIO SETS].—Section 3404 (a) (relating to manufacturers' excise tax on radio receiving sets, etc.) is hereby amended by adding at the end thereof the following new sentence: "No tax shall be imposed under this subsection with respect to the sale ~~to the United States for its exclusive use~~ of a communication, detection, or navigation receiver of the type used in commercial, military, or marine installations."

(b) TAX-FREE SALES OF RADIO PARTS.—Section 3404 (b) (relating to manufacturers' excise tax on component parts of radio receiving sets, etc.) is hereby amended by adding at the end thereof the following new sentence: "Under regulations prescribed by the Secretary, no tax shall be imposed under this subsection with respect to the sale of any article for use by the vendee as material in the manufacture or production of, or as a component part of, communication, detection, or navigation receivers of the type used in commercial, military, or marine installations ~~if such receivers are to be sold by the vendee to the United States for its exclusive use~~. If any article sold tax-free to such vendee is not so used by him, or being so used the receiver is not so sold, the vendee shall be considered as the manufacturer or producer of such article."

(c) REFUND IN CASE OF USE OF PARTS.—Section 3443 (a) (1) (relating to credits and refunds) is hereby amended to read as follows:

"(1) to a manufacturer or producer, in the amount of any tax under this chapter which has been paid with respect to the sale of—

"(A) any article (other than a tire, inner tube, or automobile radio or television receiving set taxable under section 3404) purchased by him and used by him as material in the manufacture or production of, or as a component part of, an article with respect to which tax under this chapter has been paid, or which has been sold free of tax by virtue of section 3442, relating to tax-free sales;

"(B) any article described in section 3404 (b) purchased by him and used by him as material in the manufacture or production of, or as a component part of, communication, detection, or navigation receivers of the type used in commercial, military, or marine installations ~~if such receivers have been sold by him to the United States for its exclusive use.~~"

(d) REFUND IN CASE OF RESALE TO UNITED STATES.—Section 3443 (a) (3) (A) is hereby amended by adding at the end thereof the following:

"(vii) in the case of a communication, detection, or navigation receiver of the type used in commercial, military, or marine installations, ~~resold to the United States for its exclusive use.~~"

(e) USE BY MANUFACTURER OF TAXABLE PARTS.—Section 3444 (b) (relating to tax on use by manufacturer of taxable articles) is hereby amended by adding at the end thereof the following: "This section shall not apply with respect to the use by the manufacturer, producer, or importer of articles described in section 3404 (b) if such articles are used by him as material in the manufacture or production of, or as a component part of, communication, detection, or navigation receivers of the type used in commercial, miliatry, or marine installations ~~if such receivers are to be sold to the United Staest for its exclusive use.~~"

(f) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) shall take effect as provided in section 489. The amendments made by subsections

(c) and (e) shall be applicable with respect to articles used in receivers sold ~~to the United States~~ on or after the first day of the first month which begins more than ten days after the date of the enactment of this Act, and the amendment made by subsection (d) shall be applicable with respect to articles resold ~~to the United States~~ on or after such first day.

Senator BYRD. Mr. Sprague.

STATEMENT OF ROBERT C. SPRAGUE, CHAIRMAN OF THE BOARD, RADIO-TELEVISION MANUFACTURERS ASSOCIATION

Mr. SPRAGUE. Mr. Chairman and members of the committee, my name is Robert C. Sprague. I am president of the Sprague Electric Co., North Adams, Mass., but I appear today as chairman of the board, Radio-Television Manufacturers Association.

Last November 1 an excise tax went into effect on television sets for the first time. This new tax, imposed at a 10-percent rate, had been in effect only 3 months when the Secretary of the Treasury requested that it be increased to 25 percent.

He made the same request with regard to radio sets. I am here to oppose the Treasury's proposal. I shall also explain why we think you should consider removing the tax on these important instruments of public communication.

Our industry is undergoing a trying experience.

In October 1950, before the imposition of the 10-percent tax on television sets, our industry was producing at the average rate of 210,000 television sets per week. By June, 8 months later, we were producing at the rate of only 65,000 sets per week. That is a decrease from 210,000 to 65,000.

Before the imposition of the 10-percent tax, factory sales average was 218,000 sets per week. For the month of June of this year they averaged only 39,000 sets. At the end of October 1950 inventories totaled 47,000 television sets or approximately 1 day's supply. At the end of June, 1951, there were 724,000 sets in inventory—that is at the manufacturers' level, only, and does not include the inventory at the dealers' level—or about 18 weeks supply.

As of the end of June 1951 the number of employees engaged in making television sets had declined 40 percent from the levels of June 1950. The extent of the decline would be even greater if measured from the time the tax was imposed.

This depressed condition in the industry was brought about by a number of factors which are discussed in the attached study of our consulting economists. Conspicuous among them is the 10-percent excise tax.

This depression in television set sales is not offset by military contracts. A recent survey shows that during the month of June 1951, production of military equipment accounted for an average of only 10.8 percent of the capacity of manufacturing members of the industry.

Another recent survey revealed that total employment in the industry, civilian and military, had been reduced by about 50,000 persons since early 1951. I have heard no dissent from the opinion of competent industry observers that military contracts cannot be expected to offset the loss in production and employment now being experienced. One reason for this is that at the present stage of the mobilization program, at least 50 percent of the dollar value of military electronic contracts represents foundry, sheet metal, and precision machine work, which is generally performed by companies outside the electronics industry.

One important result of the foregoing situation is that the highly trained working forces in the industry are being dispersed and will not be available when needed to produce an increasing volume of electronic equipment for the military forces.

With these facts in mind, I will speak first to the point that the tax should not be increased.

It is clear from these striking facts that any increase in the present excise tax on television sets and radios would seriously aggravate an already distressing situation—see attached study of consulting economists.

The higher prices resulting from an increased tax would cause many consumers to refrain from buying because television is unusually sensitive to price increases.

The Government-imposed freeze on new telecasting stations limits broadcasting service to approximately one-half the families of the country. Within these limited market areas those with moderate and high income tended to buy early. Thus the prospective purchasers in the market areas are largely those with incomes of less than $5,000 who, under today's conditions must be particularly price conscious. This statement is confirmed by the Federal Reserve Board's study, 1950 Survey of Consumer Finances.

This Board found that:

> The great increase in purchases of television sets during 1949 reflected in large part rapid consumer acceptance of a new product and substantial declines in prices. Reduced prices apparently brought large numbers of middle- and low-income consumers into the market. Sharply expanded buying by spending units (family groups) with incomes of less than $5,000 accounted for most of the spectacular increase in buying during 1949. The expansion was particularly marked for consumers with incomes of less than $3,000.

The 1950 expansion of sales also came largely from the income groups below $5,000. This income group comprises 83 percent of all taxpayers and it is estimated that more than 50 percent of this group were in the bracket under $3,000.

It is obvious that the impact of any increase in radio and television prices would fall more heavily upon the lower-income groups and on the segment of our economy which can least afford it.

Any increase in the tax would undoubtedly cause a further reduction in sales, resulting in a decrease in the profits of manufacturers, dealers, and distributors, and earnings of their employees and the income taxes paid by all of them. Thus an increase in excise taxes would not necessarily result in greater revenue to the Government.

I will now speak to the proposition that instead of increasing the tax, the Congress should give consideration to removing the tax.

We are conscious of the committee's responsibility to produce revenue adequate to our Government's needs in a period of world stress. It would seem indefensible, however, to raise that revenue by taxing these important instruments of public communication while leaving untaxed other household durable goods such as furniture, floor coverings, and glassware, just to mention a few items not taxed.

In time of war and public danger, television and radio are a vital means of public communication, training, and civil defense. Their distribution and use should be encouraged, rather than burdened.

Factors in favor of the removal of the tax are particularly urgent in the case of television:

First, television is a new industry. It is the traditional policy of the Congress not to tax industries during their formative periods.

The House Ways and Means Committee last year rejected the Treasury's proposal for a tax on television before the Korean outbreak, but the taxe was imposed under the stress of emergency pressures immediately following that outbreak. Television is an especially appropriate case for observance of the traditional policy because its growth has been hindered by a number of Government-imposed barriers.

Second, television combines, for the first time in history, the power of visual appeal with the circulation possibly only through home installation. It is the greatest technical instrument ever devised for public communication. Scientists tell us that 90 percent of what we learn comes through the eye. It will open a new era in Government by its power to encourage participation by the ordinary citizen in governmental affairs. This participation can be the difference between democracy and dictatorship.

Third, the damaging events which followed the imposition of the tax, referred to at the beginning of my testimony, have brought the growth of television virtually to a standstill. Removal of the tax would give it the encouragement it needs now.

Fourth, this country could hardly make a more serious mistake than by so taxing or burdening television that it is available only to the well-to-do. The New York Times has referred to television as a "new element in the functioning of Government."

In order to achieve the full promise which it holds as an instrument for strengthening democracy, television must be within reach of the ordinary citizen.

If the Congress decides that an excise tax on radio and television is unavoidable, then we propose an emergency excise tax on a broad base, which would include all household durable goods at a uniform rate and at the retail level. In the event any part of the excise tax on radio and television is retained, we would also like to see the principles of the provisions of section 482 of H. R. 4473 retained with certain modifications.

Because the radio excise tax as now imposed by an obsolete law must be applied to expanded purchases of electronic equipment for the Armed Forces, this exemption of sales to the United States is needed to eliminate many problems and uncertainties. However, this is really not enough. The same problems and uncertainties are found throughout all nongovernmental products of the industry other than the household-type receiver.

We request that you reexamine section 3404 (a) and (b) of the code. Attached as appendix A is a suggested revision of this section.

I respectfuly request that appendix A attached and Study of Our Consulting Economists, Boni, Watkins, Mounteer & Co., be made a part of the record.

Senator BYRD. Very well.

(The material referred to follows:)

APPENDIX A

DEFINITION OF RADIO AND TELEVISION RECEIVING SETS

(a) DEFINITION OF SETS.—Section 3404 (a) (Relating to manufacturer's excise tax on radio receiving sets, etc.) is hereby amended to read as follows:

"Radio receiving sets, television receiving sets, phonographs, combinations of any of the foregoing, of the household, portable, automobile, or other amusement type."

(b) DEFINITION OF COMPONENTS.—Section 3404 (b) (Relating to manufacturers' excise tax on certain components of radio receiving sets, etc.) is hereby amended to read as follows:

"Chassis, cabinets, tubes, speakers, amplifiers, power supply units, antennae of the 'built-in' type, and phonograph mechanisms (hereinafter referred to as 'radio components' for, or suitable for use as parts of or with, any of the articles enumerated in subsection (a), except when sold as component parts of a complete radio receiving set, television receiving set, phonograph, any combination of the foregoing, or other electronic apparatus. Under regulations prescribed by the Secretary, the tax under this subsection shall not apply in the case of sales of any such radio components by the manufacture, producer, or importer to a manufacturer or producer of radio receiving sets, television receiving sets, phonographs, any combinations of the foregoing, or other electronic apparatus. If any such radio components are resold by such vendee otherwise than on or in connection with, or with the sale of, complete radio receiving sets, television receiving sets, phonographs, any combinations of the foregoing, or other electronic apparatus, manufactured or produced by such vendee, then for the purposes of this section the vendee shall be considered the manufacturer or producer of the radio components so resold."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall take effect on the first day of the first month which begins more than 10 days after the date of the Act except that the related tax imposed by section 3444 (b) (on use by the manufacturer of taxable components) shall not apply to the use of components formerly included under Section 3404 (b) when contained in articles sold on and after the first day of the first month which begins more than 10 days after the date of the enactment of this Act. Refund or credit shall be allowed with respect to tax paid or incurred thereunder.

BONI, WATKINS, MOUNTEER & CO.

CONSULTING ECONOMISTS

NEW YORK, N. Y., *July 30, 1951.*

RADIO TELEVISION MANUFACTURERS ASSOCIATION,
Washington, D. C.

GENTLEMEN: This letter is in response to your request for an analysis of the impact on the radio-television market of the present 10-percent excise tax and an estimate of the effect of raising the rate still higher to 25 percent, as the Treasury has proposed.

Our analysis discloses that the radio-television market is currently not only severely depressed, but much more so than other segments of the economy which have also been hard hit. This unusual condition is attributable to a combination of circumstances, including the imbalance in the current economy created by the uneven impact in the present inflationary pressures, regulation W, the present 10-percent excise tax, television's arbitrarily narrowed market, its unusual sensitivity to the price factor and finally the uncertainties created by the color controversy. The imposition at this time of a higher excise tax would unquestionably depress and aggravate the industry sales even further.

In order to view conditions in the radio-television market in proper perspective, it is helpful to review current trends in the economy as a whole and particularly in the consumers' durable-goods sector.

CURRENT ECONOMIC CONDITIONS

By all outward indications the American economy is in a boom phase. National income is at an all-time high, and unemployment at a record low. Farm income is at peak levels. Industrial equipment (producers' durable goods) manufacturers are enjoying a record volume of new business, with unfilled orders and shipments mounting month by month to unprecedentedly high levels. Retail sales generally are being maintained at near-peak levels.

Analysis of the performance of individual segments of the economy reveals, however, that this seeming prosperity is not at all universal, and that important groups of industries are currently depressed, some acutely so.

A symptom of this imbalance in the economy is found in the divergent sales patterns of retail stores dealing in various types of merchandise. Exhibit 1 (appended hereto) provides an example of this divergence. In the exhibit are charted, for the period January 1950 through May 1951, the trends of monthly sales of nondurable-goods stores and of home-furnishings stores (which deal in durable goods such as furniture, household appliances, and radios). The chart reveals that the sales of both these retail-store groups rose to a peak in January 1951, but since then they have followed different courses. Whereas sales of the nondurable group declined moderately after January and then leveled off, with volume still above any month in 1950, sales of the home-furnishings group dropped precipitately from the January peak to a level in May below that of any month in 1950. This divergence in pattern of retail sales is one manifestation of an increasing imbalance in the economy which is being artificially nurtured, and which will certainly grow worse and create unfortunate repercussions unless soon checked.

It is also pertinent that this divergence of trend on the retail level is fully reflected on the wholesale level. In its Monthly Wholesale Trade Report for May 1951 the Department of Commerce reports, regarding wholesale trade in general, that "Wholesale dollar sales during May rose 3 percent above the April level and increased 10 percent over sales a year ago." However, the report continues, "Compared with a year ago, only four trades showed declines—commercial refrigeration (2 percent), coal (15 percent), furniture and house furnishings (16 percent), and electrical appliances and specialties (20 percent)."[1] Moreover the report also discloses that the house furnishings and the electrical appliances groups alone, among all divisions of wholesale trade, registered a decline from April to May (1951) of as much as 10 percent.

Furthermore, the recession in consumers' durable goods markets has now spread to automobiles, which constitute by far the largest element in this product class. Production of automobiles started declining in April and June output dropped to 483,153 units, or only 67 percent of the output in June 1950. The recession is also spreading to residential construction. Although home building or purchasing is technically classed as a form of investment, for the vast majority of people such expenditures represent simply the purchase of a consumers' durable goods. It is significant, therefore, that the demand for housing, paralleling the trend noted for other durable goods, has dropped sharply in recent months. Measured by the number of new dwelling starts, the downturn started in March, when the number was 21 percent below that in March 1950. The declining trend has continued and by May the number was 35 percent below the figure in May a year ago.

One of the major reasons for the sustained high-level sales of consumers' nondurable goods and the sharp decline in those of the durable-goods group is the current decline in disposable real income per capita, induced by inflation, and the accompanying diversion of purchasing power from deferrable items of consumer expenditure, such as durable goods, to nondeferrable items such as foods, for which in general the demand is highly inelastic. As evidence on this point, exhibit 2 charts the trends, in 1950 and the first 5 months of 1951, of disposable personal income, of per capita disposal real income, of retail food prices, and of retail prices generally. The exhibit shows that, although total disposable income has risen almost uninterruptedly, per capita purchasing power, as measured by disposable real income, has actually fallen and is currently below the 1950 level (annual average). The cause of this seldom-recognized fact is, of course, the rise of prices, as shown in the bottom half of the exhibit. While retail prices in general have just about kept pace with the rise in disposable income, prices of food, the most important element in the cost of living, have soared. They have risen no less than 16 percent since January 1950, far outstripping the price rise of nonfood items of consumer expenditure. In view of the fact that expenditures for food constitute approximately one-third of total consumer expenditures,[1] the exceptional rate of price advances in this sphere—a typical phenomenon of inflationary periods—has led, inevitably, to a severe curtailment of expenditures for other consumers' goods.

The foregoing data should suffice to demonstrate, first, that inflationary pressures have exerted a steadily tightening "squeeze" on consumers' purchasing power in the past year and a half and, secondly, that the impact of this development on consumers' durable goods demand has been extremely adverse, due to the differential rates of price advance for various categories of goods. In short, sharply rising food prices have diverted from consumers' durable goods markets much of the current purchasing power that would otherwise, i. e., normally, have been expended there. The resulting imbalance of the economy will undoubtedly become worse as inflationary pressures mount. To the extent that such legislative and administrative measures as excise taxes and regulation W act as additional deterrents to sales of most types of consumer durable goods (through higher prices and greater down-payment requirements), the current lop-sidedness of the economy will be further compounded. It is against this general background that we turn now to examine current conditions in the radio-television industry.

DEPRESSION IN TELEVISION

Television, the country's newest major industry, is for several reasons currently in a state of depression bordering on distress. The extent of the depression in retail sales of television sets may be seen from exhibit 3 which traces the trend, as reflected in two series: radio and appliance store sales and dealers' television sales, monthly, for the period January 1950 through April 1951.[2] The chart reveals that in April 1951 radio and appliance store sales were slightly below those in April of the previous year and about 15 percent below the 1950 average. The downward trend of television set sales is obscured in this series by the inclusion of sales of numerous other types of household appliances. The series reporting television set sales alone shows that in April 1951 they were 38 percent below the April 1950 level and about 50 percent below the 1950 average. It may also be noted that television sales have been plummeting, except for the holiday season pickup, ever since October when the revised regulation W and the excise tax went into effect.

The significance of the much greater drop in television set sales than in the total sales of radio and appliance stores can be better appreciated in the light of the fact, revealed by the Survey of Current Business monthly tabulation of retail sales by type of establishment, that radio and appliance stores were one of only two types of retail outlets that reported a lower sales volume in April 1951 than in April a year ago. Moreover, the decline for the other trade (shoe stores) was only 2 percent compared with the 11-percent drop experienced by radio and appliance stores. And in May, sales of the latter group declined still further, to a level 8 percent below the preceding month.

The depression in the radio and appliance retail trade is reflected in the rate of dealer bankruptcies in this field, exhibit 4 graphically compares the trend, semiannually, January 1950 through June 1951, of bankruptcies in all retail establishments and among radio and appliance dealers. The chart discloses that radio and appliance dealer bankruptcies rose spectacularly in the first 6 months of 1951 (222 percent of the 1950 average), whereas the bankruptcy rate among all retail establishments remained virtually unchanged (113 percent of the 1950 average).

In summary, the foregoing data demonstrate that retail television sales have declined far more than sales of appliances generally, which, in turn, are severely depressed in comparison with retail sales in other trades.

The steep and uninterrupted decline of retail television sales has been reflected, with some lag, in manufacturing activities. Exhibit 5 portrays graphically the course of television-set production, factory sales, and inventories, monthly, January 1950 through June 1951. The chart discloses that both production and sales were maintained at a relatively even rate through March 1951 and then dropped off sharply. Factory sales declined in June to a rate 58 percent below

[1] For 1949, the latest year for which data are available, for Department of Commerce reported expenditures for food of $58.6 billion, and total consumer expenditures of $17.8 billion. See Survey of Current Business, July 1950.

[2] The tend of retail sales of television sets is based on a survey conducted by the Radio-Television Manufacturers Association covering 478 dealers in 31 States, for the period January 1950 through April 1951.

that for June 1950, and 75 percent below the first quarter 1951 monthly average. Meanwhile factory inventories have mounted to almost three-quarters of a million sets, or over 18 weeks' supply at the current rate of sales compared with a 1950 average of less than 1 week's supply and a first quarter 1951 average only slightly higher. Based on the average factory price of $171 per set (as of April 1951) the indicated value of accumulated factory inventories now stands at approximately $125 million.

BASIC CAUSES OF TELEVISION DEPRESSION

The principal causes of the severe depression in the television market have been indicated in the course of the preceding review, but summarizing them here will help to point them up.

(a) Inflation, which is generating an imbalance in the economy, due to differentials in the rate of price advance in various sectors, causing a sharp curtailment of effective demand for consumers' durable goods as an increasing portion of the diminishing real purchasing power is drained away toward products (such as foods) for which the demand is comparatively inelastic.

(b) Regulation W, which by requiring larger cash down payments and shorter periods of repayment is cutting down sales of many classes of consumers' durable goods more drastically than necessary to meet the manpower and materials requirements of the rearmament program, as officially certified, and more drastically also than can be justified from the standpoint of an equitable distribution of the curbs involved in mobilizing inflation defenses. Recent action of the Congress in liberalizing regulation W terms as applied to television sets is a recognition of the seriousness of the depression in the television industry.

(c) Excise taxes, which by raising some prices, mainly those of certain categories of consumers' durable goods to uneconomic levels, out of line with other prices, have prompted impulsive shifts in the pattern of consumer expenditures, warped the trend of business activity, and aggravated the inflation-generated disequilibrium of the economy.

The above factors have adversely affected sales of other consumers' durable goods besides television—the first, sales of all such goods; the second and third, sales of only the particular categories of goods to which they apply. But in no other instance has their combined impact on sales been so depressive as in the case of television. The reasons for the exceptional severity of their repercussions on the television market may be classified under three headings: (1) A narrowed market, (2) an elastic demand, and (3) an unsettled technology. These factors will be briefly discussed in the above order.

(1) Television's arbitrarily narrowed market

Because of the Federal Communications Commission's so-called "freeze" order, temporarily withholding licenses for additional telecasting stations, television's domestic market has been, and continues to be, restricted to 63 market areas. The boundaries of these market areas are defined by the range of effective television reception from each telecasting center. Such areas encompass only about 60 percent of the country's population.

It should be emphasized that the television market is even more limited than these figures indicate. In the 63 areas presently receiving television broadcasts, only 12 are served by three or more telecasting stations.[3] Since the range of program choice constitutes a prime factor affecting television's appeal, or utility to the consumer, the prevailing thinness of program selection in most television market areas (51 out of 63) holds down demand well below the level it would otherwise reach. This is evident from exhibit 7, which tabulates saturation percentages, at the end of 1950 for the several television market areas, grouped according to the number of telecasting stations in each.[4] The following table summarizes the exhibit:

---

[3] Dallas with two stations and Fort Worth with one station are here counted as one reception area with three stations because of their proximity to each other and the overlapping of their telecasting ranges.

[4] Saturation percentage, as the term is here used, means the ratio of set installations to total number of family units (or homes). Number of families within telecasting range is based on National Broadcasting System survey demarcating areas within minimum standard television signal strength. Set installations within these areas are based on periodic surveys conducted by NBC.

Number of telecasting stations in market area	Number of market areas	Average saturation per market area
		Percent
1	39	28.7
2	11	33.0
3	8	46.3
4 or more	4	59.1

From these data it appears that the thinness of station coverage within the great majority of television market areas may be an even more important factor constricting television demand than the limited geographic scope of such market areas.

Although the Federal Communications Commission has recently taken action to hasten the lifting of the "freeze," most observers believe that it will be well into 1952 before station licenses can be issued.

At the moment the Commission has indicated it will receive comments and data until November 26 on general policy problems such as allocation principles and allotments to geographical regions and special services like educational television. These data will require at least until the end of the year. Applicants will then have 60 days in which to make their applications. Only then will the Commission begin considering and passing on the hundreds of individual applications for telecasting station licenses.

In the event of objection to its findings by unsuccessful applicants, further delays will ensue. Successful applicants will thereafter have to secure local building permits, purchase and install transmitting equipment, and plan and contract for programs before actual telecasting can begin.

In these circumstances it is quite unlikely that any new telecasting stations will be in operation before late in the spring of next year, and no substantial addition to the number of stations can be anticipated before the middle of 1952, at the earliest. Accordingly, the outlook for the proximate future is for the continued restriction of television sales to only 60 percent of the national market. No other consumer good has its market so artificially restricted.

(2) Television's highly elastic demand

The spectacular increase in consumer purchases of television sets in recent years, from 170,000 sets in 1947 to 7,464,000 sets in 1950, has been in no small measure a popular response to their declining prices. In the absence of a comparable price inducement, similar items of consumer expenditure have experienced no such increase in the rate of retail absorption. The leverage the steeply sloping television price curve gave the industry can be deduced from exhibit 9, which charts along therewith, for comparative purposes, the price trend of the entire home-furnishings group, January 1948 through April 1951. The chart displays not only the sharp absolute decline of television prices but also their relative decline, compared with prices of similar merchandise. It is noteworthy that in the last 6 months, while home-furnishings prices have risen about 7 percent, television prices have dropped about 14 percent.

The exceptional sensitivity of television-set demand to the price factor stems from the predominance of low-income groups in this market. The Federal Reserve Board compiles data on the income distribution of purchasers of various categories of consumers durable goods. These series are not kept current, but are compiled at infrequent intervals, and data for 1948 and 1949 are summarized and portrayed graphically in exhibit 8. They reveal that during the initial stages of television development (1948 and prior years), when sales were at a rate of less than 1 million sets a year and prices were high, families with an annual income of $5,000 and over purchased more than half the total number of sets sold. In 1949, however, when total set sales rose to approximately 3 million units and prices were substantially reduced (see exhibit 9), the distribution of set purchasers by income groups were reversed—income groups below the $5,000 level accounted for 60 percent of the total number sold.

This indicated trend, considered in conjunction with the large number of sets sold to date, suggests that the television market among upper-income groups is pretty well saturated and that the remaining market consists almost entirely of families earning less than $5,000 a year. Since any significant replacement demand for television sets is still a long way off, and since there is little demand evident for a second set per family, demand for television sets in the proximate future will come, even more than in 1948–49, from families in the lower-income groups. These families are, of course, more price conscious than those with higher incomes. Moreover, because of the growing "squeeze" on consumer purchasing power available for durable goods purchases (described earlier on pp. 4 and 5), the television market is especially hard hit, depending as it does on the demand from lower-income groups.

(3) Television's unsettled technology

Uncertainties regarding the ultimate outcome of current technical developments in television have engendered a "holding off" attitude among many potential set purchasers. There is a natural disinclination to buy any device that may become obsolete within a few months.

A major uncertainty centers around the color controversy. The Supreme Court's decision upholding the Federal Communications Commission's authority in the matter has not resolved the question. For one thing, the Commission has indicated that it still maintains an "open mind" on the licensing of alternative color systems should a superior one be developed and proven workable. Moreover, even were the Commission's "first choice" of the CBS system to change, or be supplemented later, the emergency of color would still be a temporary and serious deterrent to sales. For there is slight prospect of a sufficient number of color sets reaching the market in the initial stages of its commercial introduction to offset the decline in black-and-white set sales. In these circumstances, many prospective purchasers of sets are adopting a "wait and see" attitude before committing themselves to the purchase of a set.

Another technical development that is causing buyers to hold off relates to the use of ultra high frequency (UHF) wave bands. Sets presently on the market are incapable of receiving telecasts on these high frequencies. They must be adapted, at substantial extra cost, for such reception. The Federal Communications Commission has announced prospective allocation of new telecasting channels in the UHF range, but it is uncertain when telecasting thereon will begin.

SUMMARY AND CONCLUSION

In summary, it is the cumulative effect of all these special factors affecting television demand that is causing exceptionally severe depression in set sales. The net effect of the present excise tax cannot be isolated. However, in view of the composition of the television market and the uncommon elasticity of demand for sets, it is clear that the adoption at this time of any measure that will raise prices, as a higher excise tax would, will further depress sales and aggravate the industry's distress. Such a development could permanently impair the industry's productive capacity and would certainly result in a tidal wave of dealer bankruptcies.

The foregoing analysis makes plain how wide of the mark was any estimate of sustained demand for television sets in 1951 notwithstanding the impact of the excise tax and the credit restrictions imposed last fall. Such an assumption appears to have lain behind the recommendation in the Treasury's 1951 excise-tax proposals to raise the excise on television sets to the extraordinarily high and intolerably discriminatory rate of 25 percent. The analysis also serves to indicate how serious would be the consequences of imposing such a heavy additional burden on an industry whose plight is even now so desperate.

Very truly yours,

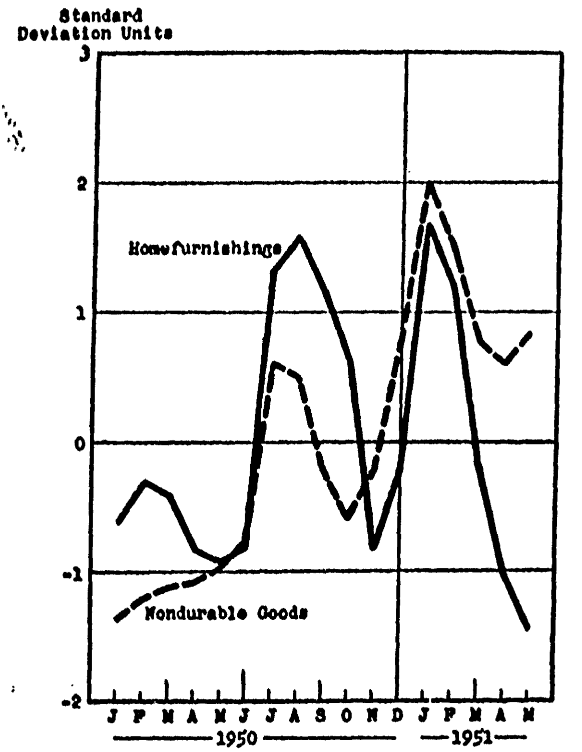
BONI, WATKINS, MOUNTEER & CO., INC.

RADIO-TELEVISION MANUFACTURERS ASSOCIATION EXHIBIT 1

RETAIL SALES OF NONDURABLE GOODS STORES AND OF HOMEFURNISHINGS STORES

JANUARY 1950 THROUGH MAY 1951, MONTHLY

(Expressed in standard deviation units to equalize amplitudinal variations)



Prepared By
[illegible], WATKINS, [illegible] & CO.
Incorporated
Consulting Economists New York, New York

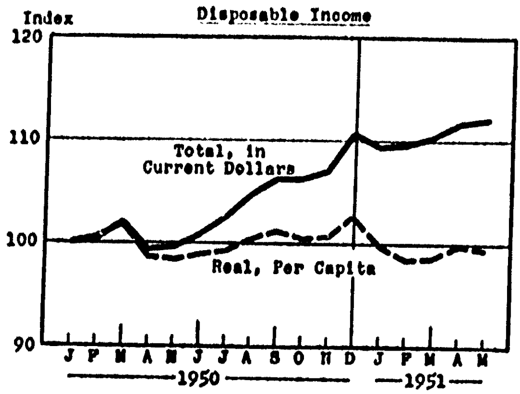
RADIO-TELEVISION MANUFACTURERS ASSOCIATION

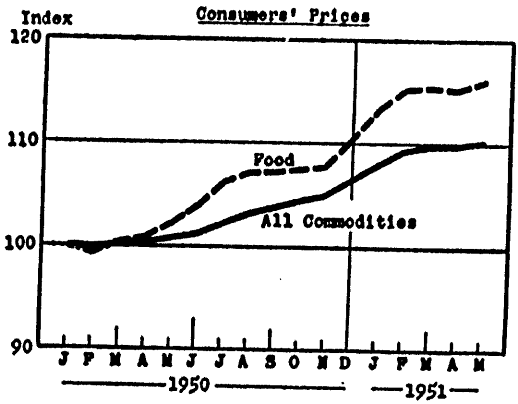
EXHIBIT 2

CURRENT TRENDS OF DISPOSABLE INCOME AND CONSUMERS' PRICES

JANUARY 1950 THROUGH MAY 1951, MONTHLY

(Indices: January 1950 = 100)





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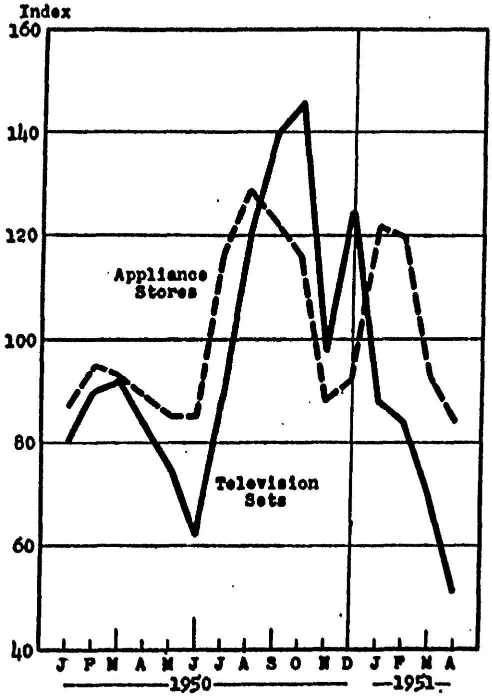
RADIO-TELEVISION MANUFACTURERS ASSOCIATION

EXHIBIT 3

RETAIL SALES OF HOUSEHOLD APPLIANCE AND RADIO STORES
AND OF TELEVISION SETS

JANUARY 1950 THROUGH APRIL 1951, MONTHLY

(Indices: 1950 = 100)



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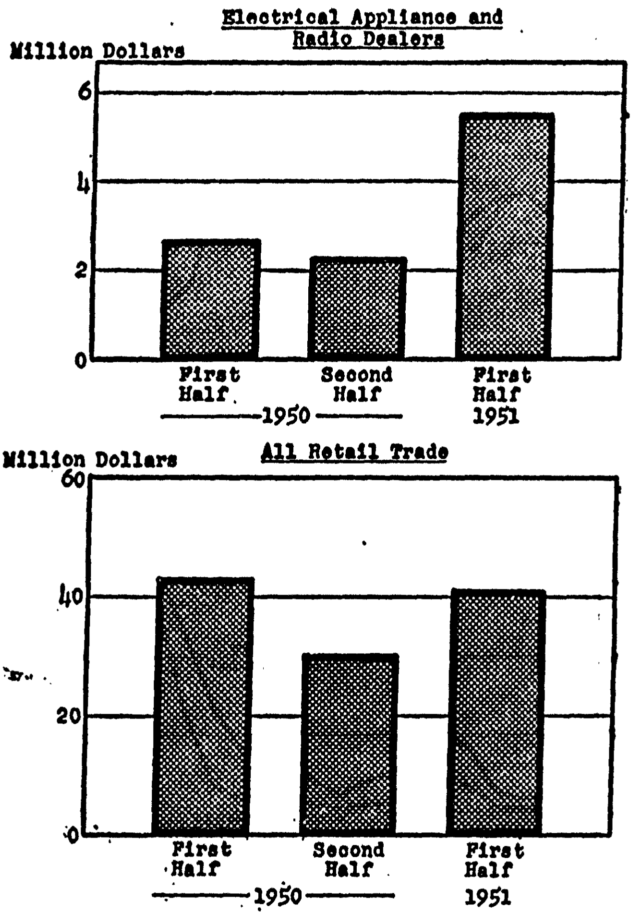
RADIO-TELEVISION MANUFACTURERS ASSOCIATION EXHIBIT 4

TOTAL LIABILITIES OF FAILURES OF ELECTRICAL APPLIANCE AND RADIO DEALERS AND OF ALL RETAIL TRADE

JANUARY 1950 THROUGH JUNE 1951, BY HALF-YEAR PERIODS



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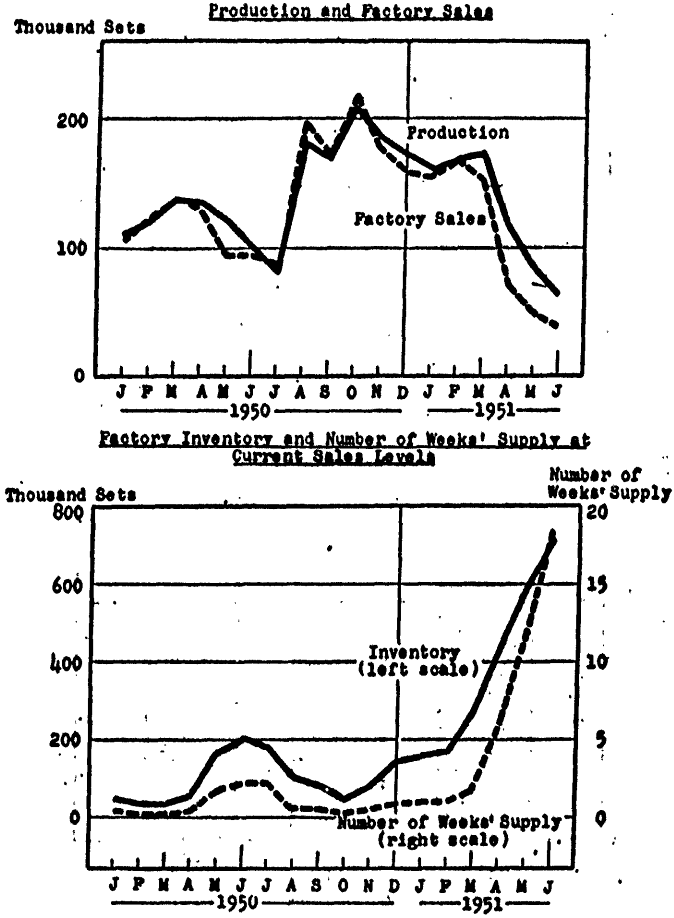
RADIO-TELEVISION MANUFACTURERS ASSOCIATION **EXHIBIT 5**

TELEVISION SETS: AVERAGE WEEKLY PRODUCTION AND FACTORY SALES AND END-OF-MONTH FACTORY INVENTORY

JANUARY 1950 THROUGH JUNE 1951, BY MONTHS



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[illegible] & CO.
Incorporated
Consulting Economists New York, New York

EXHIBIT 7

Television set saturation in market areas, grouped by number of telecasting stations in each area, as of Dec. 31, 1950

Market areas and number of stations	Percent saturation	Market areas and number of stations	Percent saturation
1 station:		1 station—continued	
Albuquerque	14.50	Wilmington	58.62
Ames	[1] 17.26		
Binghamton	21.96	Average	28.73
Bloomington	3.96	2 stations:	
Buffalo	53.80	Atlanta	42.59
Charlotte	16.40	Birmingham	16.51
Erie	32.24	Boston	53.23
Grand Rapids	31.75	Davenport-Rock Island-Moline	24.06
Greensboro	10.93	Dayton	56.31
Houston	17.37	Louisville	26.28
Huntington-Ashland	18.54	Minneapolis-St. Paul	32.71
Indianapolis	28.38	Omaha	25.60
Jacksonville	16.00	Salt Lake City	18.83
Johnstown	30.25	San Antonio	18.64
Kalamazoo	35.54	Syracuse	47.64
Kansas City	23.74		
Lancaster	56.12	Average	32.95
Lansing	26.80		
Memphis	22.26	3 stations:	
Miami	24.45	Baltimore	61.40
Milwaukee	44.15	Cincinnati	50.53
Nashville	12.05	Cleveland	53.85
New Haven-Waterbury	43.54	Columbus	48.69
New Orleans	21.97	Dallas-Fort Worth	24.70
Norfolk-Newport News	25.96	Detroit	44.68
Oklahoma City	18.35	Philadelphia	63.80
Phoenix	12.65	San Francisco-Oakland	22.67
Pittsburgh	37.31		
Providence	[illegible].60	Average	46.29
Richmond	22.09		
Rochester	49.16	4 or more stations:	
San Diego	38.88	Chicago	57.62
Schenectady-Albany-Troy	43.97	Los Angeles	49.83
Seattle	[illegible].16	New York-Brooklyn-Newark	60.86
St. Louis	39.69	Washington, D. C.	67.93
Toledo	43.72		
Tulsa	[illegible]	Average	59.06
Utica	[illegible]		

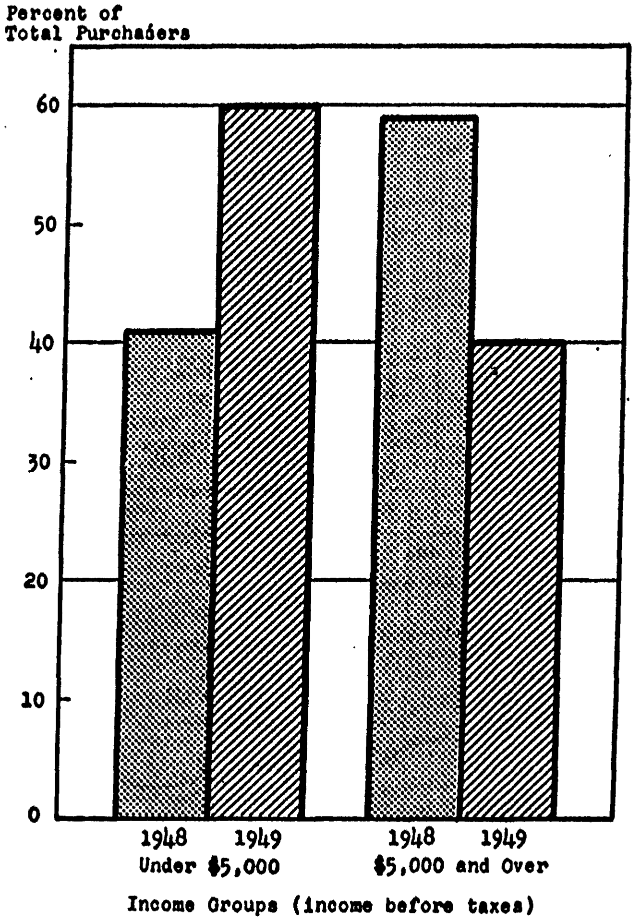
[1] Based on National Broadcasting Co. data.

Source: Radio-Television Manufacturers Association.

RADIO-TELEVISION MANUFACTURERS ASSOCIATION **EXHIBIT 8**

FEDERAL RESERVE BOARD STATISTICS DEMONSTRATE CONCLUSIVELY THAT ACTUAL PURCHASERS OF TELEVISION SETS ARE PREDOMINANTLY IN THE INCOME GROUP EARNING BELOW $5,000

1948 and 1949



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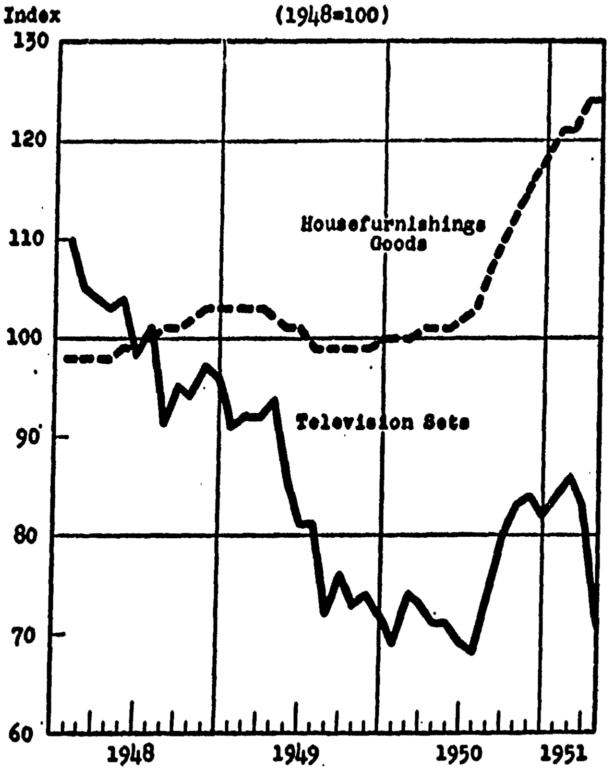
Consulting Economists New York, New York

RADIO-TELEVISION MANUFACTURERS ASSOCIATION **EXHIBIT 9**

INDICES OF WHOLESALE PRICES OF TELEVISION SETS
AND OF HOUSEFURNISHINGS GOODS

JANUARY 1948 THROUGH APRIL 1951*



Prepared by
BOHN, WATKINS, MOUNTEER & CO.
Incorporated
Consulting Economists New York, New York

SCHEDULE FOR EXHIBIT 1.—*Retail sales of nondurable-goods stores, and of home-furnishings stores: Actual and adjusted to equalize amplitudinal variation January 1950 through May 1951*

Year and month	Nondurable goods store sales: Actual[1] (million dollars) (1)	Nondurable goods store sales: Adjusted[2] (standard deviation units) (2)	Home furnishings store sales: Actual[1] (million dollars) (3)	Home furnishings store sales: Adjusted[2] (standard deviation units) (4)
1950:				
January	$7,297	−1.37	$592	−.62
February	7,359	−1.21	616	−.30
March	7,391	−1.12	608	−.41
April	7,401	−1.09	576	−.83
May	7,440	−.98	569	−.92
June	7,519	−.77	576	−.83
July	8,021	+.60	739	+1.32
August	7,987	+.51	760	+1.59
September	7,716	−.23	727	+1.16
October	7,580	−.60	687	+.63
November	7,717	−.23	576	−.83
December	8,094	+.80	625	−.18
1951:				
January	8,535	+2.00	707	+1.09
February	8,352	+1.50	730	+1.20
March	8,085	+.77	627	−.16
April	8,018	+.59	503	−1.00
May	8,110	+.84	530	−1.44

[1] Adjusted for seasonal variation.
[2] Adjusted to equalize amplitudinal variation, in order to make the two series comparable for the purpose of analyzing their patterns of movement. The average for the period January 1950 through May 1951 was computed for each series and the individual data were then expressed in terms of deviations from their respective averages. These deviations were then translated into standard deviation units.

Source: (1) and (3)—United States Department of Commerce, Bureau of Foreign and Domestic Commerce, Survey of Current Business.

SCHEDULE FOR EXHIBIT 2.—*Indexes of total and of per capita real disposable income and indexes of consumers' prices of food and of all commodities, January 1950 through May 1951*

[January 1950=100]

Year and month	Indexes of disposable income[1]: Total income (1)	Indexes of disposable income[1]: Per capita real income (2)	Indexes of consumers' prices: All commodities (3)	Indexes of consumers' prices: Food (4)
1950:				
January	100.0	100.0	100.0	100.0
February	100.3	100.4	99.8	99.4
March	102.1	101.8	100.1	100.3
April	99.3	98.6	100.2	100.7
May	99.6	98.4	100.7	101.9
June	100.8	99.0	101.2	103.6
July	102.5	99.4	102.3	106.2
August	104.7	100.5	103.1	107.1
September	106.3	101.2	103.8	107.1
October	106.2	100.5	104.4	107.4
November	107.1	100.7	104.9	107.6
December	110.9	102.7	106.3	110.4
1951:				
January	109.4	99.7	107.9	113.2
February	109.6	98.4	109.3	115.3
March	110.3	98.6	109.7	115.4
April	111.8	99.8	109.8	115.2
May	112.1	99.5	110.2	116.0

[1] Adjusted for seasonal variation.

Source: Derived from U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Survey of Current Business.

SCHEDULE FOR EXHIBIT 3.—*Indexes of retail sales of household appliance and radio stores and of television sets January 1950 through April 1951, monthly*

[1950=100]

Year and month	Household appliance and radio store sales [1] (1)	Television set retail sales (2)
1950:		
January	87.3	80.1
February	95.2	90.0
March	92.8	91.8
April	88.7	82.7
May	84.6	75.8
June	84.9	61.7
July	117.1	89.0
August	128.8	120.5
September	123.3	140.0
October	116.1	145.6
November	88.4	98.1
December	92.1	125.0
1951:		
January	121.6	88.3
February	119.5	84.5
March	93.2	69.7
April	83.6	50.9

[1] Adjusted for seasonal variation.

Source: (1) Derived from U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Survey of Current Business.
(2) Special survey of 473 television dealers conducted by the Radio-Television Manufacturers Association.

SCHEDULE FOR EXHIBIT 4.—*Total liabilities of failures of electrical appliance and radio dealers and of all retail trade, January 1950 through June 1951, by half-year periods*

Year and period	Electrical appliance and radio dealers	All retail trade
1950:		
First half	$2,666,000	$42,583,000
Second half	2,253,000	30,108,000
1951: First half	5,452,000	40,906,000

Source: Dun & Bradstreet, Inc.

SCHEDULE FOR EXHIBIT 5.—*Television sets: Average weekly production and factory sales and end-of-month factory inventory, January 1950 through June 1951, by months*

Year and month	Average weekly production	Average weekly factory sales	End-of-month factory inventory: Total	End-of-month factory inventory: Number of weeks' supply (Column 3 divided by column 2)
	(1)	(2)	(3)	(4)
1950:				
January	106,675	106,750	46,800	0.44
February	119,975	123,950	30,900	.25
March	137,320	137,400	30,800	.22
April	135,650	130,125	52,000	.40
May	121,800	93,925	162,900	1.73
June	106,800	92,840	201,200	2.17
July	81,875	86,500	182,700	2.11
August	180,150	190,025	107,200	.56
September	168,700	173,540	83,300	.48
October	209,575	218,575	47,300	.22
November	184,700	176,975	78,200	.44
December	171,700	158,580	143,800	.91
1951:				
January	161,420	155,178	155,564	1.00
February	169,830	106,721	107,999	1.01
March	174,927	154,732	268,972	1.74
April	117,289	71,542	451,963	6.32
May	84,783	49,207	594,209	12.08
June	65,300	39,381	723,909	18.38

Source: Radio-Television Manufacturers Association.

SCHEDULE FOR EXHIBIT 8.—*Percentage distribution of actual buyers of television sets by income groups, 1948 and 1949*

Income group	1948 (1)	1949 (2)
Under $2,000	3	4
$2,000 to $2,999	....	16
$3,000 to $3,999	21	26
$4,000 to $4,999	17	14
Total under $5,000	41	60
$5,000 and over	59	40

Source: Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, July 1950, p. 786.

SCHEDULE FOR EXHIBIT 9.—*Indexes of wholesale prices of television sets and of housefurnishings goods, January 1948 through April 1951*

[1948=100]

Month	1948		1950		1949		1951	
	Television sets (1)	Housefurnishings goods (2)	Television sets (1)	Housefurnishings goods (2)	Television sets (1)	Housefurnishings goods (2)	Television sets (1)	Housefurnishings goods (2)
January	110	98	69	100	91	103	84	121
February	105	98	74	100	92	103	86	121
March	104	98	73	101	92	103	83	124
April	103	98	71	101	94	102	72	124
May	104	99	71	101	86	101		
June	98	99	69	102	81	101		
July	101	100	68	103	81	99		
August	91	101	74	107	72	99		
September	95	101	80	110	76	99		
October	94	102	83	113	73	99		
November	97	103	84	116	74	99		
December	96	103	82	118	72	100		

Source: (1)—Derived from Radio-Television Manufacturers Association.
(2)—Derived from U. S. Department of Labor, Bureau of Labor Statistics, Wholesale Prices bulletins.

Senator BYRD. Mr. Hardy.

STATEMENT OF RALPH W. HARDY, DIRECTOR OF GOVERNMENT RELATIONS FOR THE NATIONAL ASSOCIATION OF RADIO AND TELEVISION BROADCASTERS

Mr. HARDY. My name is Ralph W. Hardy.

I am director of Government relations for the National Association of Radio and Television Broadcasters, and I appear at this hearing in behalf of that organization.

The National Association of Radio and Television Broadcasters is a trade association whose members are engaged in all forms of broadcasting—amplitude modulation, frequency modulation, and television. The association has a membership of approximately 1,400.

The operators of the broadcasting stations of this country have consistently opposed the principle of placing an excise tax on the means of the public's reception of the program material released daily by the public's reception of the program material released daily by the nearly 3,000 AM and FM stations, and the 107 new television stations in this country.

When you compare that number of broadcasting stations with the approximately 1,900 daily United States newspapers, you immediately see the significant position of the medium of broadcasting. The reliance of the general public upon radio and television as a major source of news and general information is an established fact clearly indicated in Nation-wide surveys of the information-acquiring habits of our people.

Radio has become such an integrated part of our lives that its presence and constant and instant availability is taken for granted as a necessary adjunct of the American home. In those areas where television programing has been available to the public, the same patterns of utilization and dependence are firmly established.

I make these points at this hearing, because it is not uncommon to hear the expression "Radio and television sets are luxuries, and they belong in the class of goods properly marked for excise taxes."

We think the overwhelming judgment of the owners and prospective buyers of radio and television sets, based upon their own appraisal of the functional purpose of these modern instruments of communication, would not agree with such an opinion.

The times in which we live afford frightening evidence of the absolute necessity for the means of instantaneous communications to the widely scattered people of our country. Whether it be for the more dramatic events such as air-raid warnings and instructions, pronouncements of national import by the Government, debates and hearings on national and international issues, election procedures, or the continuing and vital job of maintaining the news channels open for the incalculable strength of an informed citizenry, the broadcasting service of this country has long since arisen out of the novelty and gadget and luxury class.

The Congress has recognized that the gathering and dissemination of news, by whatever means, is too vital a function in the United States to be burdened. This is shown not only by the subsidizing of the mailing of newspapers, magazines, and books but also by the excise-tax statutes themselves.

Thus section 3466 of the Internal Revenue Code expressly exempts from the tax on telegraph, telephone, radio, and cable facilities—

> Services or facilities utilized in the collection of news for the public press or radio broadcasting, or in the dissemination of news through the public press or by means of radio broadcasting.

Section 3443 permits the credit or refund of any excise tax paid on motion-picture film "for use in the making of newsreel motion-picture films."

In view of these provisions, the excise tax on radio and television receivers is completely illogical. It is obviously inconsistent to exempt the facilities necessary for the gathering and dissemination of news and at the same time to tax the facilities indispensable for its reception by the public. The relationship between dissemination and reception is so close that a burden upon one is in fact a burden on the other.

In testimony before the House Ways and Means Committee on this same subject, I directed their attention to a significant declaration by George Washington that has a direct bearing on one vital issue in this connection.

President Washington, in a historic message to the Congress urging them to repeal the transportation tax on newspapers, reminded the legislators:

> No resource is so firm for the Government of the United States as the affection of the people guided by an enlightened policy; and, to this primary good, nothing can conduce more than a faithful representation of public proceedings diffused without restraint throughout the United States.

Annihilating time and space as they do, radio and television, if kept free from discriminatory tax encumbrances to their circulation by way of the required receiving sets, have the capacity to break down economic barriers to full enlightenment and understanding far beyond the dreams of our first President who prayed for the "faithful representation of public proceedings diffused without restraint throughout the United States."

But what has been done? Already the Government has imposed a "transportation tax" of 10 percent on our modern version of Washington's prized facility. And now the Congress—first the House of Representatives, and now your distinguished body in the Senate—has been asked to require the people of this country to pay to the Government a premium of 25 percent of the manufacturers' price of new radio and television sets for the privilege of availing themselves of these infinitely more efficient and effective means of diffusing the "faithful representation of public proceedings."

The House, as you know, rejected the proposed increase from 10 to 25 percent, and we are all very grateful for their action in so doing.

Broadcasters who have chafed for a long time under the discriminatory aspects of this excise tax on the means of the public's reception of their programs cannot help but wonder what public reaction would be if, following the same principle upon which the tax is imposed on broadcast receiving sets, a similar tax were to be imposed upon the circulation means of daily newspapers. Would there not be a hue and a cry if the newsboys accosted you with a story like this: "The Government has placed a 25-percent excise tax on the subscription price of this newspaper. From now on there will be this tax penalty for the use of your daily newspaper." Certainly the broadcasters advocate no such tax on newspaper subscriptions.

I can assure you the subject of this tax has long ago ceased to be an academic one for radio and television people. All over the country the broadcasters have talked with the wholesale and retail merchants who sell the radio and television receiving sets to the public. They have watched inventories pile up. They have watched public buying stiffen to a near standstill.

They have listened to buyer after buyer asking "How much Federal tax is there on this set?"

They have talked with county agricultural agents and heard their reports on deteriorating farm radio receiving equipment and heard of the reluctance to replace obsolete sets because of prices already out of range of the family pocketbook. They know from first-hand experienc that every price or tax rise cuts back their service potential in inhibiting new buyers who are just as vital to them in terms of circulation as are the subscribers to newspapers.

In the final analysis, all a broadcaster has to offer to those who use his facilities, be they sponsors, public servants, artists, or whatever, is audience.

The struggle for audience—its size, its composition, its loyalty—is the very essence of the competition that fires our American free-enterprise broadcasting system.

It is because of this that the broadcaster looks with great concern on any device that has the effect of placing discriminatory restrictions on this all-important audience.

We honestly believe that the excise tax on radio and television receivers does just that, and for that reason, and upon that principle, as broadcasters we raise our voices against it and respectfully urge this Senate Committee on Finance to reach the conclusion that there is merit in the preservation of free channels to the homes and hearth-sides of America for all of the media of public information and enlightment.

This free channel for radio and television is impeded by the imposition of the excise tax.

We urge you, as a matter of principle, to reject it.

Senator BYRD. Thank you very much, Mr. Hardy.

I submit for the record a statement by Mr. Ralph L. Van Name, secretary, New York City Employees' Retirement System, entitled, "Certain Recurring Arguments Opposing Greater Income-Tax Exemption for Pensioners," as well as a copy of the speech made by Congressman Sidney A. Fine in the House of Representatives on Wednesday, June 20, 1951. Mr. Van Name's request for appearance was not received until after the schedule of witnesses had been closed. Therefore, it was impossible for the committee to receive his views in person.

(The two documents referred to follow:)

AN ANSWER TO CERTAIN RECURRING ARGUMENTS OPPOSING GREATER INCOME-TAX EXEMPTION FOR PENSIONERS, SUBMITTED BY RALPH L. VAN NAME, SECRETARY, NEW YORK CITY EMPLOYEES' RETIREMENT SYSTEM

Argument 1.—Discrimination against persons who live on their own savings would be shown by exempting pensioners and not individuals.

Answer 1.—The discrimination is not theoretical; the discrimination is now practiced wholesale by the United States Government. The Federal Government now exempts up to $1,800 social-security income of 45,000,000 of the low-paid and high-paid in industry—a majority of the country's workers—as they attain age 65, whether their other income is $5 or $5,000 or $50,000. The Federal Government also discriminates to exempt the pension of millions of military personnel, railroad workers, printers, etc., to a greater or lesser degree, while the few self-supporting aged individuals and 6,000,000 governmental employees, as they retire, are income-taxed.

The practice is no longer based on size or need, since the new social-security untaxed pensions will average as high as taxed governmental pensions.—Federal, State, city, court, and teaching.

As to total, report of the Senate Committee on Finance accompanying submission of the present new social-security law indicates the prospect of addition of another tax-exempt $1,000,000,000 a year to the social-security rolls in the next year or two.

Many high-bracket taxpayers are being professionally advised to pay their $54 a year (1½ percent of $3,600) not only because of the possible $1,800 social-security pension itself but for the $1,800 tax exemption, which is worth an additional $1,800 a year to a taxpayer in the 50 percent bracket.

Only fear of loss of present right to retire before age 65 with taxpayer assistance prevents huge groups of local governmental employees in many States from electing entrance upon tax-exempt social security at $54 a year or less. Meanwhile, the Federal Government taxes not only the below-age-65 pensions of governmental pensioners, but the over-65 pensions comparable in amount and average to social-security pensions to be granted under the recently adopted social-security tax-exempt scale.

No sound reason can be given for exempting from income tax social-security pensions of the high-paid and low-paid, while taxing governmental pensions—Federal, State, city, court, and teaching—up to $400 as proposed in the tax bill now under consideration in the Senate Committee on Finance.

Argument 2.—Young wage earners are entitled to exemption equal to that granted to the aged retired.

Answer 2.—The Federal Government conspicuously neglects that precept. It assists States in granting relief up to $900 a person out of taxes paid by the young; it exempts up to $1,800 pension payable to most pensioners (Federal, State, and city pensioners excepted); then it limits millions of single young wage earners to less than $700 exemption.

A. Their income may be less certain.

Answer A: Wage earners are not taxed on the wages they may earn; only on wages actually received. They meet inflation with increased wages.

Governmental pensioners on fixed income and increasing income taxation have no recourse but again and again to reduce their standard of living as Government, again and again, taxes and taxes, spends and spends.

In millions of cases, measured by reasonable and widely accepted standards, Government is now forcing these fixed income, taxable governmental pensioners beneath the subsistence level. With its own retired civil service workers, for example, it goes through the business of increasing somewhat their inadequate pensions, on the one hand, and, on the other, taxing at 20 percent pensions in the \$700-\$1,800 range from which nongovernmental social-security pensioners—the retired from 45,000,000 in industry—would be totally exempt.

The \$700-\$1,800 wage earner may look for increased income as inflation proceeds: the \$700-\$1,800 taxed governmental pension not only does not rise with inflation; it is further reduced by increased taxation as well as by decreasing purchasing power.

B. They may have to live in more costly neighborhoods.

C. The may have greater day-to-day expense.

Answer B-C: The heavy sickness and disability special requirements of the aged so far exceed those of young and vigorous workers that Government and private groups vie to provide partial assistance for the peak need.

Congress, in 1950, lifted social security from the pauper assistance stage for far fewer to the \$1,800 maximum self-help basis for industrial workers, 45,000,000 of them. Congress rightly regards aged income in the lowest \$1,800 area as appropriate for exemption regardless of exact lesser exemption limits of young workers.

Notwithstanding tax-free assistance up to \$900 regardless of age and tax-free social-security pension up to \$1,800, Congress has continued to tax aged governmental pensioners in the lowest \$1,800 area. Much of the cheerfulness with which industry's workers, 45,000,000 of them, pay their annual social-security contribution of \$54 or less springs from the knowledge that not only pension income to \$1,800 but tax exemption to \$400 and more is being purchased.

Actually, young wage earners need not be exempted in the same degree that the pensioned aged should be exempted, because, generally, they like the practice of paying during their productive years for prospective tax-free existence on a lower (usually half-pay) standard of living in old age.

Unfinished business dictates that the remainder of the aged, those retired and retiring from 6,000,000 governmental positions, be given tax privileges identical with the majority of the other aged.

Argument 3.—Married persons over 65 are sid to have \$2,675 tax exemption—four \$600's adjusted upward on the return to \$2,675.

Answer 3.—45,000,000 industrial employees, as they attain age 65, may have up to \$4,475 exemption—\$2,675 as above, plus up to \$1,800 tax-free social-security pension. Governmental pensioners receiving \$1,800 governmental pension would have \$1,800 less exemption. Congress may properly determine the tax-exemption ceiling. It is inexcusable that, year after year, Congress compels its own employees and the employees of local government to pay up to \$400 more income tax than the pensioners of private industry.

Example.—A married 65-year-old bus driver on the privately owned Third Avenue Railroad in New York retires on \$1,800 social-security pension with \$2,675 other income, all totally exempt from income tax. A married 65-year-old bus driver on the parallel municipal bus route in New York retires on \$1,800 municipal pension with \$2,675 other income. The latter will pay, depending on exactly the new scale of taxation, \$350 to \$400 income tax from which his privately employed fellow union member is tax free. Thanks to Federal discrimination, one takes home \$1,800 pension; the other, \$1,400.

That \$400 governmental tax discrimination on \$1,800 pension income of two men of identical title and wage in the same union is a matter of serious economic and political importance to more than 30,000 members of the Transport Workers Union and to the over-all CIO organization.

If Federal discrimination of this sort is not ended, pivotal States and districts will be won and lost in protest against congressional neglect, year after year, to equalize pension-income taxation.

Argument 4.—It has been argued that since social security, until recently, averaged only about \$516 a year and railroad pensions less than \$1,000, whereas all over 65 are exempt to \$1,333 and married couples to twice that sum, the average social-security and railroad pensioners are not benefited by their additional special exemptions running up to \$1,440 and \$1,800.

Answer 4.—Averages are what they are because of the lesser and greater than average figures commingled to make the average. That some railroad and social-security pensioners receive less than $1,000 and less than $516, as they do, does not of itself justify exemption of railroad and social-security pensioners whose pensions of $1,440, more or less, keep the low average from falling lower.

In the next year or two, with the addition of $1,000,000,000 a year to the social-security rolls, as expected by Senate and House tax-fixing bodies, the present averages will become inconsequential and obsolete. Congress need not apologize for deliberately passing the present social-security law to greatly increase the social-security average. Taxation of the $1,400 pension, which combines with the $400 to make the average, should not stand or fall because of $400 treatment. Each level should be determined on its merits.

POSITIVE REASONS FOR GREATER TAX EXEMPTION OF AGED GOVERNMENTAL PENSIONERS

Limited exemption from income taxation of the aged governmental pensioners is to be justified for the following reasons:

1. Income taxation of the aged is uneconomic. Never before has income tax law condoned $1,800 tax exemption of most pensioners and withheld it from other (governmental) pensioners.

It is as sound economics to untax people during their unproductive years as to tax them during their earlier productive years. Thus is provided fair and equal treatment to each citizen at successive stages of each citizen's life.

2. Anticipatory taxation of the aged before old age is preferable and is preferred by young and old.

3. Government revenues would not suffer by anticipatory taxation (taxation during productive years). The Government itself has argued at times that social security tax exemption is inconsequential. Exemption of fewer (one-seventh as many) governmental pensioners would be of less consequence. The small amounts involved have been noted in official reports to the tax-making committees of the Senate and the House.

4. Taxation of long-lived aged pensioners substitutes high income taxation for lesser inheritance taxation. The income of the long-lived aged pensioner is possible through forfeitures of the short lived which the long-lived inherit. Other heirs share $60,000 estate exemption: here, too, governmental pensioners are the forgotten stepchildren.

5. Pensioners commonly retire on about half pay; that is, pensioners are commonly persons who have been accustomed to a standard of living double that possible for the remainder of life. Considerations of decency should prompt lighter taxation for their few remaining years.

6. If it is social security for private industry, Congress makes $1,440 tax free available after as little as 1½ years and after contrbution by the worker of as little as $81.

If it is governmental pension, Congress taxes $1,440 pension income $288 annually, more or less, after a lifetime of service. Why?

7. Tax exemption of social security pensioners was begun when the pension was small and the recipient poor. Under 1950 social security law, taxpayers in the 50 percent bracket have the equivalent of $3,600 additional other income, since they would pay $1,800 tax were it not social security.

With this Government bounty to the rich, there is no sound basis for withholding tax exemption in the $1,800 area to underpaid, underpensioned Government workers one-seventh as numerous, and with one-seventh the income of 45,000,000 industrials.

8. In both Government and industry, employer contributions for employee pensions are generally tax-exempt on the way in. In industry, they are also exempt on the way out via social security. Government employer money, on the other hand, is not exempt on the way out to the pensioner. It is taxed at 20 percent, more or less, compared to industry's 0. Why?

The overtaxation of governmental pension cuts two ways. It reduces the governmental pensioner's take-home pay and his standard of living. It compels taxpayers to raise additional millions of tax money to be siphoned from the local treasury to the Federal Treasury from private industry. Why the discrimination? Why?

9. Congress does not seek a profit from social security operation. It would be pleased if the Government were to break even.

Besides huge sums for the needy poor, New York City raises $100,000,000 a year for staff pensioners—persons retiring from its employ. New York City's staff pension appropriation must be as large as $100,000,000 annually because the

Federal Government, which seeks no profit from industry's contribution for pensions, collects an income tax beginning at 20 percent, from those whose pension income is derived from New York City taxpayers' local tax payment.

What have the States and cities done that their taxpayers and their employees retired should be worse treated taxwise, than industry and industry's 45,000,000? Local taxpayers and State and city pensioners are also people—and voters.

10. Finally. Unquestionably, present congressional treatment of the governmental pensioner is unplanned, inadvertent, accidental. Present congressional treatment cannot be condoned or justified. Congress need not apologize for or explain its past neglect. It must begin, now, equal tax treatment of industry's pensioners and Government's pensioners.

Why Not Equalization of Tax Exemption?

(Speech of Hon. Sidney A. Fine, of New York, in the House of Representatives, Wednesday, June 20, 1951)

Mr. Fine. Mr. Speaker, I would like to make the point that since the tax bill now before us is being considered under a closed rule, there will be no opportunity to offer an amendment during the debate except through the committee. I therefore address these remarks to the committee and respectfully urge them to amend the bill to provide the same tax exemption for governmental pensioners now provided for social-security pensioners and for railroad pensioners. The omission of this important provision has resulted in the following inequitable situation:

Consider the tax problem of three separate individuals doing the same type of work, one employed in private industry, the second by a railroad, and the third by a municipality. The first and second gain a tax exemption of $1,800 and the third no tax exemption at all on retirement. The first two take home $1,800 in pension pay; the third only $1,395 in pension—all income being the same.

The unfairness of the situation is even better pointed out by the following forceful illustration: Where we have a privately owned bus line which has been taken over by a municipality, the employees of said privately owned bus line already retired and receiving social security, or who retire just before unification, are given a tax exemption, but those who become part of the municipal scheme and later retire as members of the municipal pension system do not get the tax exemption.

What difference can there be between a social-security pensioner, a railroad pensioner, and a governmental pensioner? None, of course. And yet, the committee has rejected a provision sponsored by our colleague and member of the committee, the gentleman from New York, the Honorable Eugene Keogh, which would have eliminated this rank discrimination. What justification can there be for this differentiation?

The fight to put governmental pensioners on the same plane with social-security pensioners is being led by Ralph L. Van Name, the fiery secretary of the New York City retirement system who has lined up in support of the program the leading civil-service and public-employee organizations as follows:

New York State Joint Council Government and Civic Employees Organizing Committee, CIO.

The Civil Service Employees Association.

Civil Service Technical Guild.

Civil Service Forum.

The National Education Association.

The Congress of Industrial Organizations.

New York and New Jersey Retired Teachers Association.

National Association of Retired Teachers.

Retired Patrolmen's Association.

In addition to these organizations, organized Government employee groups and retired employee associations in California and Ohio and elsewhere are mobilizing for action on the controversy.

Much credit is due not only to Mr. Van Name, but also Mr. Jesse B. McFarland, president of the Civil Service Employees Association of the State of New York, Mr. Philip F. Brueck and Mr. Raymond E. Diana, chairman and executive secretary of the New York State Joint Council of the Congress of Industrial

Organizations, respectively, and the many other officials of the employee groups for their untiring efforts to bring about equality in treatment.

My interest in this legislation stems from my many years of active identification with these men and organizations and I am grateful to them for supplying me with information and data in the preparation of this statement. An analysis of said information and data supports the need for the adoption of the amendment.

First. Under the present income-tax bill, employees are taxed more if they retire from 1 of the 7,000,000 Federal, State, and city positions than if they retire under social security from 1 of the 45,000,000 positions in private industry. This is violently discriminatory.

Second. Pensioners are usually aged people. Income taxation of the aged forces continuance of aged employment to the detriment of youthful employment and advancement. Governmental pensioners, whose pension at one twenty-fifth of $1,800, that is, $72 for each year of 25 to age 65 are obliged to work seven additional years to age 72 to produce the $522 Federal income tax which would leave them with the $1,800 take-home pension available 7 years sooner to social security's untaxed $1,800 pension. Governmental pensioners must work up to 7 years longer solely because of Federal discrimination against governmental pensioners in income taxation.

Third. The tax bill as presently written continues an unconscionable hardship upon old persons who have served their adult lives in Government employment, and offers an additional argument for those who claim that Government service is growing less attractive in relation to private industry.

Fourth. It has been suggested that by this method, governmental employees would be compelled to become part of the social-security system to gain the tax exemption now in the law—certainly not a laudable way to treat the problem. If this be the motive, it amounts to an unfair trade practice and should be condemned. Furthermore, to force the many city and State employees into the Federal plan would be depriving them of all of the benefits of pension systems built up over many years of trial and error. The complexity of the change-over and the inherent difficulties, would make the transition much too difficult and costly.

Fifth. The place to derive taxes is from production. The time to derive pension tax income from the first-bracket taxpayers is during their productive years. Any first-bracket taxpayer—and there are millions of them—would prefer to pay more during his productive years, so as to be relieved of income taxation during his aged unproductive years. The Government would suffer no loss by using common sense in this matter. During his productive years, the taxpayer properly provides: (a) for his current needs, (b) for the current needs of the Government, (c) for the anticipated needs of his old age. If his successors do likewise as they would prefer to do, there will be no need to tax first-bracket aged. Certainly, this is true within the $1,800 area established for 45,000,000 industrial employees and ignored by Congress as to 7,000,000 governmental employees and pensioners.

* * * * * * *

Seventh. Governmental pensioners who survive their expectation of life as at their retirement age, are scheduled to benefit from the forfeiture to the fund of the capital equities of short-lived pensioners. The only way first-bracket wage earners may provide for costly survivorship in their eighties and beyond is by mutual consent at the outset to short-lived forfeitures to make possible long-lived payments if long life ensues. The Federal Government which provides tax free $1,800 income to industrial pensioners does not merely tax governmental pensioners similarly situated. If taxes, on an annual income-tax basis, inheritance received in annual installments by long-lived pensioners from short-lived pensioners—through retirement fund, of course. It is unprincipled and discriminatory to free industrial pensioners from all tax on $1,800 pension and then to tax governmental pensioners on an annual income-tax basis with that which is not annual income but annual installments of the inheritance by the long-lived from the short-lived through the retirement fund.

Eighth. The income which a Government employee earns is taxed as he earns it precisely as is the preretirement income of employees in private industry who are covered by social security; taxation of governmental employees should cease at retirement as it does prior to social-security retirement.

CONCLUSION

I suggest to the committee one of two proposals. Either that the bill be immediately amended to bring about even-handed justice in this regard or to agree to offer an amendment so that we, the Members of the House, may, by our votes, determine the question. By this method at least we can once and for all solve the problem of whether or not public employees are to be differently treated taxwise.

Senator BYRD. The Chair inserts numerous statements and letters in the record at this point.

STATEMENT OF EDWARD J. BRECK

1. My name is Edward J. Breck. I am vice president of John H. Breck, Inc., 115 Dwight Street, Springfield 3, Mass.

2. We are manufacturers of Breck hair and scalp preparations, including three different types of hair shampoos. John H. Breck, Inc., was created in 1929 as the outgrowth of a business providing hair and scalp treatments for men and women, established in 1907 by my father. In other words, we, the Breck family, have been shampooing heads of both men and women for over 40 years.

3. I submit this statement in opposition to the proposal of the Treasury Department to extend the definition of "toilet preparations," as it is found in section 2402 (a) of the Internal Revenue Code, to include shampoos containing more than 5 percent of saponaceous matter, and thereby place a 20-percent Federal retailers' excise tax on such shampoos.

4. Earlier this year the Secretary of the Treasury, in his statement to the Committee on Ways and Means, proposed that a 20-percent Federal retailers' excise tax be imposed on shampoos containing more than 5 percent of saponaceous matter in the 1951 tax bill then under consideration by that committee.

5. I appeared before the Committee on Ways and Means and submitted reasons why an excise tax should not be imposed on shampoos containing more than 5 percent. My statement before the Committee on Ways and Means appears on pages 2490 to 2493 of the printed hearings before that committee (pt. 3, Revenue Revision of 1951).

6. American women and men are thankful that the Committee on Ways and Means and the House of Representatives rejected the proposal of the Treasury Department to impose a tax on shampoos containing more than 5 percent saponaceous matters in approving H. R. 4473, the Revenue Act of 1951. The reason they are thankful is because, first, a shampoo containing more than 5 percent saponaceous matter is a soap, or its equivalent, and secondly, the primary function of a shampoo—just like a soap—is to clean. Regardless of its constituent materials and irrespective of the form, whether it be a liquid, paste, jelly, cream, or powder, a shampoo is, in effect, soap and is used to cleanse the hair and scalp of men, women, and children. So, the American public rejoiced at the action of the Committee on Ways and Means from a feeling that things had not gotten so bad that the Government had to impose a tax on cleanliness.

7. Despite the rejection of its proposal to tax shampoos by the Committee on Ways and Means and the House of Representatives, the Treasury Department recently made a similar proposal to the Committee on Finance of the Senate (see statement of Secretary Snyder before Senate Committee on Finance, June 28, 1951, table 4, schedule B: Miscellaneous excise-tax proposals).

8. As a result, it is necessary for me to again emphasize the primary purposes of shampoos containing more than 5 percent saponaceous matter and to point out why these items should not be made subject to a Federal retailers' excise tax.

9. Cleanliness and those products which promote it are not luxuries under American standards of living. Soaps, solid or liquid, lathering or nonlathering, synthetic or natural, which promote cleanliness are necessities in our country today.

10. Congress, in 1938, made its decision that soaps and shampoos were necessities and not luxuries when it terminated the manufacturers' excise tax which had been levied on those items, along with mouth washes and dentifrices. In the short time that they were taxed, they were taxed at the manufacturer's level at 5 percent as compared to other toiletries at 10 percent. In doing so, Congress recognized that any preparation that promotes the hygiene of the body, mouth, hair and scalp, is in a somewhat different category from those toilet preparations solely intended to beautify and promote attractiveness or alter appearance, and on which an excise tax was maintained.

11. You will recall that even during World War II, when the problems of financing that crises called for drastic action on the part of Congress, you did not see fit to impose an excise tax on such necessities as shampoos, soaps, mouth washes and dentifrices.

12. Shampoos are widely used day-in and day-out in every season by American families and such wide usage stamps these items as necessities in the American life.

13. Fawcett Publications in December 1950 completed 10 years of surveying personal preparations used by women. In 1942, which, in my opinion, was 10 years after the actual birth of the shampoo industry, according to this Fawcett survey 93 percent of the women reporting used shampoo in their home. Their 1950 survey stated a 97 percent usage. These surveys are typical of many surveys made by the publishers of such magazines as Good Housekeeping, Woman's Home Companion, and others, all of which indicate that approximately 97 to 98 percent of American families use hair shampoos.

14. In my own family, where there are six children from age 8 to 16, it is just as necessary to shampoo at age 8 as it is at age 16. Parents are the ones that know the 8-year-old should be shampooed for cleanliness purposes. At age 16, the girls, and I think boys, too, feel the need of shampooing for cleanliness, and of course, at that age for attractiveness, too.

15. I might point out here, without attempting to imply that I am a medical authority, that frequently at the teen-age level, it is necessary for both boys and girls to shampoo frequently. Many youngsters are confronted during that adolescent period with an acne condition, a very oily skin, scalp, hair. Cleanliness, while not a cure for such conditions, is a necessary adjunct to treatment.

16. For the older person, both male and female, frequently dry, oily hair and scalp and dandruff conditions can be helped by proper shampooing.

17. From time to time in this country, there have been epidemics of ringworm of the scalp among school children. Again, shampoos are not a cure for that skin disease but I feel that it indicates a definite need that the hair and scalp of men, women, and children should be kept clean and the easiest, simplest way to do it is by the use of a good shampoo.

18. Bar soap can be used to shampoo just as bar soap can be used to clean the teeth. I am sure that you feel that modern dentrifrices do a more efficient job of cleaning the teeth than bar soap and so also have shampoos replaced bar soap to clean the hair during the past 20 years.

19. Shampoos have increased tremendously in usage in the American home, because they accomplish better than any other materials a specific, specialized function—that of properly cleansing the hair and scalp. Bar soap has never been satisfactory for shampooing, particularly in the case of the long hair of women. The outer layer of the hair shaft is frequently likened to shingles on a roof. These tiny barbs on the hair are apt to catch and hold particles of bar soap, thus preventing free and clean rinsing of the hair. This undesirable action is particularly pronounced in hard water areas and it must be realized that the great majority of our people live in hard water areas.

20. The business of my own company, while that of manufacturing and selling hair and scalp preparations, is basically shampoos. During the past 5 years our variation from quarter to quarter differs only 9 percent between our lowest quarter and our highest quarter, indicating, I believe, a pretty consistent general year-round use of shampoo. In other words, it isn't a seasonable business. Shampoos are used, like bar soap, on a pretty consistent basis every month of the year.

21. Part of our total volume of shampoos is sold in the beauty shop field. The beauty shops cannot operate their business without shampoos.

22. The beauty shop business has had rather rough going in the last 4 or 5 years, due to some extent to the competition from home permanent waves, but mainly however, due to the decreased purchasing power of the American woman's dollar, increased cost of operating her home, feeding her family, etc. Now the Treasury Department proposes that she be further taxed if she is going to shampoo at home when she cannot readily afford to attend a beauty shop as frequently as she did a few years ago.

23. Perhaps a man cannot afford shaves in his barber shop because of the need of every dollar to support the family, yet the Treasury does not propose to tax shaving soap. He can shave at home without paying a tax.

24. The Bureau of National Affairs, Inc., in publishing, "Survival Under Atomic Attack as well as other similar direction folders, indicates that anyone exposed to radioactivity material or radio-activity should bathe with warm water and

soap. The National Affairs Bureau folder says, "In washing, pay particular attention to your hair for that is one place the waste is sure to pile up."

25. While that is rather a solemn note and a condition which certainly we all hope no one in America has to face, I could inject a little lighter note by referring to a cartoon which appeared in the February 16 issue of Time magazine in which an advertising executive, talking to the research librarian against a background of books, is saying, "Find out if any soap manufacturer has ever used the slogan, 'It gets you clean.'"

26. Shampoos should not be put at the disadvantage of being subject to a 20 percent excise tax when soap apparently is not going to be taxed. Shampoos are one of the few soaps or its equivalent preparations that small business can manufacture. Soap, bar and cake soap, powdered soap, etc., are manufactured by big business. There are many more brands of shampoo than there are brands of bar soap simply because the small manufacturer can manufacture shampoo with a minimum amount of investment in equipment and he can enjoy that privilege which is still American—the freedom to sell.

27. I feel that the American people are aware of the need for raising revenue to finance the mobilization program. However, I am sure they also feel that if excise taxes must remain as a part of our revenue system for an indefinite time, then they must be levied fairly and in a non-discriminatory manner. Shampoos are cleansing agents and, like soap, a necessity in America and our way of life today. Neither soap nor shampoos should be made subject to excise taxation. However, any proposal to tax shampoos and not soap is discriminatory and will work an unnecessary hardship on consumers and producers of shampoos.

28. The Treasury Department has estimated that a 20 percent tax on shampoos will yield about $8 million in taxes annually. I am sure the Congress will feel that the Government can forego this insignificant amount in order to promote the health and cleanliness of the Nation's hair and scalps.

29. In conclusion, the Committee on Finance of the Senate is respectfully requested to follow the action of the Committee on Ways and Means and the House of Representatives in rejecting the proposal to impose a 20 percent Federal retailers' excise tax on shampoos containing more than 5 percent saponaceous matter.

BAR ASSOCIATION OF THE DISTRICT OF COLUMBIA,
Washington, D. C., July 31, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: I enclose herewith a copy of a resolution adopted July 31, 1951, by the board of directors of the Bar Association of the District of Columbia, urging the adoption of the amendment to H. R. 4473, which was proposed by Senator Ives and referred to your committee on July 25, 1951.

As you know, the proposed amendment would permit the postponement of tax on a limited amount of the income of the self-employed, if paid into a retirement fund, thus placing the self-employed professional man on an equality with corporate employees who now enjoy this opportunity to build up a reasonable retirement fund.

In the interest of fairness and equity, we respectfully urge the favorable consideration of this amendment by your committee, and that this resolution be included in the record of the current hearings on H. R. 4473.

Sincerely yours,

LEONARD P. WALSH, *President.*

Whereas the present high levels of Federal taxation on earned income make it virtually impossible for professional persons and other recipients of earned income to provide for their retirement from their income; and

Whereas the problem of providing retirement benefits has to a great extent been solved for corporate employees by section 165 of the Internal Revenue Code; and

Whereas the need for such retirement benefits is equally great in the case of professional persons and other persons having earned income but not covered by a pension plan; Now, therefore, be it

Resolved, That the board of directors of the bar association of the District of Columbia favors in principle amending the Internal Revenue Code so that taxpayers not covered by a pension plan qualified under section 165 of the Code may be encouraged by a tax credit, a tax deduction or other means to accumulate, out of current earned income, funds which would be available under appropriate regulations of the Treasury Department to provide retirement income for such taxpayers; and be it further

Resolved, That the president of this association be directed to urge upon the appropriate committees of the Congress the adoption of the amendment to H. R. 4473 proposed by Senator Ives and referred to the Senate Finance Committee by the Senate on July 25, 1951.

STATEMENT OF STANLEY VAN DAMM, ELIAS KRAFT & CO., NEW YORK, N. Y.

Recommendation to make average base-period computation more equitable to corporations formed during the base years (1946–49).

It is my opinion that the Excess Profits Tax Act is equitable, that it has one major inequity which is not glaring only because those corporations that are at an unfair or inequitable disadvantage are small corporations formed during the period 1946–49; of this group those having the greater efficiency are subject to the greater inequity.

The Excess Profits Tax Act presumes 1946, 1947, 1948, and 1949 to be (peace years) normal years. As such I have termed earnings during this period as "normal earnings."

Let us illustrate a case—a small corporation is formed June 30, 1948. It is a very efficient firm and until December 31, 1949, makes $180,000 or an average of $10,000 a month. This corporation actually has an average annual earning of $120,000 made in what is considered normal years—normal earnings such as these are not excessive. I do not think that such earnings, continued after December 31, 1949, were thought by Congress to be excessive, yet the result taxwise is just that. Actually this is the computation of the average annual earnings under the Excess Profits Tax Act, for such a new corporation organized June 30, 1948:

1946	0
1947	0
1948	$60,000
1949	120,000
Best 3 years	120,000
Average annual earnings	60,000

A corporation formed before 1946 has many advantages. Nineteen hundred forty-six basically was a prosperous year. The average annual earnings take the best 3 out of 4 years of actual earnings. Thus:

1946	$250,000
1947	150,000
1948	80,000
1949	120,000
Best 3 years	450,000
Average annual earnings	150,000

The new corporation was in business 18 months in the base-period years and made $180,000, or an average of $120,000 a year, but finds itself using $60,000 for tax computation.

The corporation in business 4 years actually earned $300,000, or an average of $75,000 a year but finds itself using $150,000 for this tax computation.

The old corporation thus has an obvious advantage, which it is fortunate to possess. But why unduly penalize a new corporation for not having engaged in business during the Second World War? In one case I represent a client who got out of the Army during the base-period years, formed a small corporation with certain other individuals. He and his family own almost all of the stock. He is the only officer drawing a salary—but because he was in the Army, he is now penalized in just such an instance.

Let us explore beyond this immediate hardship that is applied to a new corporation. All corporations are allowed an alternative, i. e., 12 percent of its capital and surplus, but most corporations organized during the base-period years do not have large capitals; nor have they been in business long enough to accumulate a large surplus; thus, this alternative is not to the advantage of a new corporation.

As to relief sections, and there are many relief provisions, all of them are open only to corporations organized prior to January 1, 1946, with one exception; the one exception is the dubious relief that is given to new corporations. That is a ratio of their industry's earnings to their assets. This ratio is computed by combining the average of all corporations' profits to assets; the average includes the efficient and the inefficient—an immediate disadvantage to an efficient organization. Many efficient firms turn over their money many times during the year, thus requiring less assets. In preparing tax returns this year I could use this new corporation formula in only one instance; in that case the taxpayer through inefficiency and bad purchases had abnormally large assets, but their bad business judgment gave them large assets and an advantage under the new corporation formula over a competitor with about the same capital who did a bigger business with less assets.

Any corporation formed at least 1 year before December 31, 1949, has had an opportunity of earning normal profits even if the start is slow, as it is with most new corporations. Why should they not be permitted to use their actual average earnings? Why treat corporations formed in peacetimes as if they were war babies formed after Korea? This inequity can be corrected by permitting new corporations to use their actual base-period average. It is my further recommendation that this inequity should be corrected retroactively to the beginning of the Excess Profits Tax Act.

Statement of John E. O'Neill, General Counsel of the Small Brewers Association

My name is John E. O'Neill. I am an attorney and my office address is suite 604, Washington Building, Washington, D. C. I appear today as general counsel of the Small Brewers Association. The main office of the Small Brewers Association is 188 West Randolph Street, Chicago, Ill.

The Small Brewers Association is the largest American trade association of brewers in point of membership. It numbers in its membership approximately 250 of the 407 breweries now operating in the United States. While these small brewers constitute a majority of the breweries in the United States, the volume of their production is estimated to be only about 30 percent of the total volume of production.

Due to the local and sectional nature of the operations of these small plants, and the pressure of competition from large producers, they would be more acutely affected by increased excise taxes than their large heavily financed competitors who do a national business. The Treasury Department's proposal to increase the beer excise tax from $8 to $12 a barrel, if adopted, would bankrupt half of the small breweries in the United States who are even now struggling to survive under the heavy tax burden imposed by Federal, State, and local laws.

SMALL PLANTS NEED TAX RELIEF

The last time I appeared before this committee in February 1950 I urged the committee, on behalf of small brewers, to reduce the beer excise tax from $8 to $7 a barrel, if not for the industry generally, at least for the small units of the industry. In connection with this recommendation I pointed out the growing trend toward concentration of production in fewer and fewer plants, and the increasing number of failures and bankruptcies among local operators. The situation has not changed in the past year. The four largest brewers in the United States now enjoy over 21 percent of the total volume of business, whereas in 1945 the four largest companies enjoyed only 11.8 percent of the business. This growing trend toward concentration is further indicated by the fact that the 25 leading breweries in the United States now enjoy more than 50 percent of the total of the volume of business, while the other 50 percent is divided in varying poportions among the other 375 plants. In 1934 there were 725 breweries operating in the United States. At the end of the last fiscal year, according to internal revenue statistics, there were 407 plants operating. During that period the volume of beer production has increased from approximately 30 million barrels to approximately 89 million barrels annually. Of the 318 breweries that closed since 1934, about 60 failed in the past 3 years.

AN INCREASED EXCISE TAX WOULD FALL MOST HEAVILY UPON SMALL OPERATORS

The large manufacturer in every field, as a matter of common knowledge, has competitive advantages over the small producers. His very bigness gives him the competitive advantage. The brewing industry is no exception.

In the brewing industry the prices charged by the large producers, for their nationally distributed beers, are substantially above the level of prices charged by their local and regional competitors. Consequently, with an equal rate of tax on all production, it is obvious in the case of local beers sold by small brewers that the tax represents a substantially higher percentage of the sales price than in the case of the nationally advertised brands. A Massachusetts brewer called me only a few days ago to point out that his product sells for $24 a barrel, which includes the $2 per barrel State tax and the $8 Federal tax. In his case, 42 cents of every dollar represents excise taxes. On top of that he pays occupational taxes and license fees, and income taxes if he has any income left.

Wisconsin and Missouri beer sells in Massachusetts for $30 a barrel, including the State and Federal tax, so that the tax on these higher-priced beers represents only 33⅓ percent of the sales price. If the Treasury's proposal for an additional $4 increase is adopted, 50 cents of every dollar the local brewer collects for his draft beer will be paid over in excise taxes. The large brewers' contribution will be proportionately less.

The situation in Massachusetts is typical of the country. It can be said conservatively that in the case of the average small brewer, the tax on his production represents from 40 to 45 percent of his sales price, as compared with 33⅓ percent of the sales price in the case of large producers.

AN INCREASED EXCISE TAX WILL REDUCE CONSUMPTION

Because of high prices, necessitated by high taxes, the per capita consumption of beer in the United States is lower today than it was 5 years ago. During the late war, and for some time thereafter when payrolls were high, and money free, the volume of beer production held up even under the burden of high excise taxes. However, for the past three fiscal years, according to internal revenue reports, the volume of beer production has dropped, as follows:

Fiscal year ending June 30—	*Barrels produced*
1948	91,291,219
1949	89,735,047
1950	88,807,075

Most of the loss in this volume of business was felt by the smaller plants who could not finance large advertising programs to keep up sales.

Any increase in current tax rates, with resulting increases in the sales price, will undoubtedly accelerate the trend toward reduced beer production, and this will be felt first by the small local units of the industry who sell the economically priced beer and whose principal patrons are those in the lower-income brackets.

INCREASED BEER EXCISE TAXES WOULD DISCOURAGE MODERATION

Beer is the beverage of moderation. It is lower in alcoholic content than any other alcoholic beverage. It has high nutritional value as a food and it is healthful to consume. Beer is the workingman's drink and it should be priced within the reach of the workingman. The days of the 5-cent glass of beer are gone, and the 10-cent glasses are becoming smaller and smaller, because of increased costs and increased taxes. An additional 50-percent increase in the Federal excise tax would eliminate the 10-cent glass of beer, and place the cost of the product beyond the reach of many beer consumers in the working class. This indeed would constitute a blow to the cause of moderation in alcoholic beverage consumption and would not be for the good of the country.

The Treasury's proposal of the 50-percent increase in the excise tax on beer is also highly discriminatory, when considered in the light of its proposal that distilled spirits taxes be increased by only 33⅓ percent. If alchoholic-beverage taxes need to be increased to raise the revenue, it is certainly illogical to impose the highest percentage increase upon the beverages containing the lowest alcohol.

CONCLUSION

In conclusion, the Small Brewers Association respectfully urges your committee not to report favorably upon any increase in the current rate of excise taxes upon beer because—

1. The burden of such an increase would fall most heavily upon small producers and force many of them out of business;

2. Further increases in beer taxes would discourage moderation in the consumption of alcoholic beverages;

3. Such an increase would place the cost of the working man's drink beyond the reach of the workingman;

4. The Treasury proposal of a 50-percent increase in the beer excise tax is highly discriminatory.

NEW YORK STATE BANKERS ASSOCIATION,
New York, N. Y., July 31, 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee of the Senate,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: The New York State Bankers Association represents 97 percent of all commercial banks in the State of New York, and these banks constitute a major segment of the banking system of the country. Because of the importance of these banks in the Nation's economy, we urge that consideration be given to alleviating the burden that the excess-profits tax, in its present form, places upon many of these banks.

The inflationary trend of our times has caused a tremendous increase in bank deposits and risk assets. To protect these risk assets adequately, many of the banks should raise additional capital funds, and this can be done by only two means: (1) the obtaining of fresh capital and (2) the retention of a fair amount of the net earnings and profits, after the payment of reasonable dividends. Either method fails of success if there is not adequate earning power, and it is evident that this earning power is presently and prospectively lacking when one finds so many bank stocks selling at 25 to 30 percent discount from book value.

While gross operating income has improved, the additional earnings have not kept pace with the rise in expenses and higher income taxes. A further decrease in net operating earnings can be expected in many banks as a result of the provisions of the excess-profits-tax law which reduces the exemption credit from 12 percent on the first $5,000,000 of invested capital to 10 percent on the second $5,000,000, and to 8 percent on the balance of invested capital. After allowing for the approximately 50 percent normal and surtax income rates, this means that such banks will be permitted yields of only 6, 5, and 4 percent before being subject to excess-profits taxes.

Yields of less than 6 percent would not appear to be large enough to justify being classified or considered as being "excess profits." Such low limits also appear to be discriminatory when compared with the more favorable treatment accorded to public utilities and railroads.

To rectify this situation, to strengthen the capital funds of banks, and to protect the investments of hundreds of thousands of holders of bank stocks, we strongly urge that the law be amended to provide a flat exemption credit of 12 percent of invested capital, irrespective of amount.

Respectfully yours,

WILLIAM T. TAYLOR,
President, New York State Bankers Association.

STATEMENT OF HERBERT C. JACKSON, PARTNER, PICKANDS MATHER & CO., AND CHAIRMAN OF TAX COMMITTEE OF LAKE SUPERIOR IRON ORE ASSOCIATION, CLEVELAND, OHIO

IDENTIFICATION AND QUALIFICATION

I am Herbert C. Jackson, a partner in the firm of Pickands Mather & Co., of 2000 Union Commerce Building, Cleveland, which operates iron-ore mines in the Lake Superior district of Minnesota, Michigan, and Wisconsin.

I appear also as chairman of the tax committee of the Lake Superior Iron Ore Association, representing most of the companies which mine and ship iron from the Lake Superior district, which normally supplies more than 80 percent of all the iron ore required for the iron and steel industry of the United States.

The iron-ore activities of our firm include both open-pit and underground operations, involving all types of mining of both shallow and deep ore bodies. During the past 5 years, as managers, we produced and shipped 16 percent of total output of the Lake Superior district.

My duties with Pickands Mather & Co., presently and for the past 35 years, have been intimately connected with iron-ore mining.

SUBJECT

My comments are directed to the support of section 302 (a) (D) of the pending revenue bill, H. R. 4473, relating to the treatment of expenditures for the development of mines. This proposed amendment to the tax laws is of great importance to the iron-ore industry which I represent, and I understand is likewise important to many other branches of mining. However, I shall confine my discussion to the significance of this provision as regards iron-ore mining with which I am familiar.

Representative John R. Dingell of Michigan, member of the Ways and Means Committee, who is an ardent advocate of conservation and development of our natural resources, has been the earnest sponsor of this amendment, as a measure to stimulate development of latent, vitally needed mineral resources, not only in Michigan but throughout the Nation.

As stated in the Ways and Means Committee report, this amendment is intended to eliminate "a serious obstacle to the expansion of the mining industry" which exists because of the present arbitrary rule requiring that all development costs in excess of net receipts from any minerals produced while a mine is in the development stage must be capitalized and recovered through the allowance for depletion.

I assure you that the existing rule is a serious deterrent to developing and bringing into production new iron-ore mines which are absolutely vital to maintaining the supplies of iron ore on which our national economy and security depend. The present national emergency makes it imperative that our supplies of mineral raw materials—of which iron ore is paramount—be expanded rapidly, not only because of the need for the minerals but because only increased production can provide the new sources of tax revenue on which the Government depends. Laws and regulations which destroy incentives to production, and thus the sources of income, must be modified.

The confiscatory tax rates on individuals in the upper income brackets, as proposed in the pending bill, go far to destroy the sources of income sought to be taxed. Whether or not the country can long survive this sort of taxation on its individuals is a question, but there can be no question that unreasonable taxation cannot be applied without disastrous results to the productive enterprises vitally needed in the defense effort and for the general welfare of the Nation at all times.

Section 302 (a) (D) will provide a real incentive to the expansion of iron-ore capacity and production, thereby accomplishing a twofold purpose of providing both an essential raw material and additional sources of tax revenue.

TREATMENT OF NEW MINES UNDER EXISTING LAW

The House committee report points out that the existing law and regulations require that while a mine is in the "development stage," that is, prior to the time the main business of the operation is production of ore, the net cost of the development must be capitalized and recovered out of the depletion allowance, whereas after a mine has reached the "production stage," the identical type of development costs are no longer treated as capital charges recoverable through depletion, but are deductible operating expenses, as they should be.

The effect of requiring preproduction development costs to be capitalized and recovered through depletion is disastrous to the depletion allowances of prospective new iron-ore mines in the Lake Superior district, because the tremendous preproduction costs of developing the remaining deeper and smaller ore bodies, when amortized in future costs, practically cancel the percentage depletion allowance.

The difference in tax treatment of development expenditures incurred prior to the production stage and of identical expenditures made after the mine is in the production stage is purely arbitrary. It creates serious inequities and definitely hinders the development of the reserves in deep open pit mines and deep underground mines from which most of the future high grade natural ores must be produced. This distinction between preproduction and during-production development expenditures was established in 1934, quite contrary to the previous 20-year history of Bureau practice. It was also at variance with the so-called Parker report of the Joint Committee on Internal Revenue Taxation, used by Congress in 1932 as a basis for its determination of the depletion allowance at the time percentage depletion was extended to metal mines, including iron ore mines. This report, based on a careful statistical study, showed that the actual depletion allowed iron ore mines by the Bureau during the 5-year period, 1922 to 1926, inclusive, amounted to 17.74 percent of their gross income. This allowance was in addition to the amortization of all capital costs for development, both preproduction and during production. If development costs were to be recovered through depletion, as subsequently determined by the Bureau, this percentage would have been higher.

In 1934 the distinction between preproduction-development expenditures and expenditures for development after reaching the productive stage was not too important to the iron-ore industry. At that time the ore reserves in the Lake Superior district, as estimated by the various State tax commissions, in terms of the then current shipments, apparently were ample for many decades. Iron ore was a drug on the market, the open-market sale price per ton being about equivalent to the price of a ton of gravel. The general feeling in the industry that iron-ore reserves were practically inexhaustible, and certainly ample supplies of ore were readily available. At that time also the existing open-pit and underground mines had been in operation for many years; thus preproduction development expenditures had been largely recovered. These development expenditures then were never too significant, because the large open pits had required relatively little stripping prior to starting production, and the underground mines were relatively shallow and the cost of shaft sinking relatively low.

An example of the changed situation with reference to preproduction-development expense is indicated by the experience of my firm. In the open-pit mines, which we now operate, it has only been necessary to remove, on the average, less than 1 ton of stripping per ton of ore developed for mining, whereas from the proposed open pits which we either are now stripping or hope to strip in the future, an average of about 6 tons of stripping is required for each ton of ore. In contrast to the large and wide open pits of the past, these new pits are small and confined, and much deeper, requiring removal of 200 to 400 feet of surface deposit before the ore body is reached. Practically all of this overburden must be removed prior to production of ore. The average cost of removing 6 tons of material is approximately $1.20, which is decidedly more than the allowable percentage depletion per ton of ore mined. Thus, the present requirement that preproduction development be recovered out of the percentage depletion allowance has the effect of completely eliminating percentage depletion as a deduction for these new open pit mines.

A similar situation exists with respect to the underground mines. With some exceptions, prior to 1934 underground mines generally reached depths of only about 500 to 1,800 feet, whereas the prospective future underground mines now possible to be developed will be 3,000 to 5,000 feet or more in depth. Shaft sinking, which, prior to 1934, cost less than $100 per foot, now costs about $500 per foot, and other costs likewise are greatly magnified. These increased preproduction development costs, amortized over the tonnage benefited, and recovered through percentage depletion as presently required, greatly reduce or even eliminate the percentage depletion deduction for these prospective new deep, underground mines.

If the essential new iron ore productive capacity is to be allowed a percentage depletion deduction that means anything, then the changed physical conditions accompanying the development of these new mines requires a change in the revenue laws, so that preproduction development expenditures will be rightly considered as advance operating expense, to be deferred and recovered independent of the percentage depletion allowance.

The proposed amendment in section 302 is intended to provide the same treatment for preproduction development as for the later development expenditures when the mine is in production. This amendment recognizes the fact that preproduction development is simply an advance operating expense, to be deferred and deducted ratably against the tonnage benefited, the same as any other operating expense which may not properly be deducted in the year made.

The amendment at once eliminates a legal inequity and at the same time gives encouragement to every producer of iron ore to open new properties. With this discrimination against new mines eliminated, operators of such properties can look forward to competing on a more nearly equal basis with the old established but exhausting mines.

THE NEED FOR NEW IRON ORE MINES

I have already referred to the vital need for increased iron-ore supplies to support the expanding steel production, and this is well known to all of you. A simple fact that may not be so well known, is that this country does not lack adequate reserves of iron minerals, for in its combined remaining high-grade and low-grade deposits, there is sufficient iron to support the steel industry for an indefinitely long period. What we do lack are sufficient reserves presently developed to produce, for a prolonged period, the anticipated annual iron-ore requirements of the steel industry. We must develop new iron-ore mines to replace existing mines which will become exhausted in the near future. Our dire need is sustained annual productive capacity of iron ore, rather than reserves.

This year the production of iron ore in the Lake Superior district will exceed 90,000,000 tons. Present operating mines cannot long continue to yield this large annual production and, unless new mines are developed promptly to replace those being exhausted, there will be a drastic curtailment in annual productive capacity in a relatively few years.

This curtailment need not occur. As I have stated above, ample reserves of iron minerals are available in the Lake Superior district, and annual productive capacity can be maintained and increased if development of such reserves is given the necessary stimulus. This will mean development, at previously untouched depths, of underground mines in Michigan and Wisconsin, and of deep flat ore bodies in Minnesota requiring extraordinary stripping. Also, it will mean the development of production from the practically inexhaustible supplies of low-grade iron-bearing rock, the so-called "taconite" of Minnesota and the "iron formations" of Michigan and Wisconsin.

However, the development of production from the low-grade taconite and other iron formations involves vast expenditures of risk capital for pioneering in new fields. In order to give positive encouragement to the very large expenditures for plant and equipment and preparatory work in these enterprises, the tax relief offered by this amendment relating to development expenditures is wholly inadequate. Congress should give consideration to more positive measures to stimulate the creation of productive capacity from these new sources.

For the benefit of the country, not only in the present emergency but for the long future, it should be evident that the tax discrimination against the development of new mines needs to be promptly eliminated. The proposed amendment in section 802 is intended to accomplish this. By encouraging needed new developments, it will foster increased domestic production of iron ore and other minerals, with all the obvious benefits to our self-sufficiency and our security as a nation, and to the revenue requirements of the Government.

MEDICAL SOCIETY OF THE COUNTY OF NEW YORK,
New York 20, N. Y., July 31, 1951.

HON. WALTER F. GEORGE,
Senate Finance Committee, Washington, D. C.

DEAR SENATOR GEORGE: At the stated meeting of the Medical Society of the County of New York held on April 23, 1951, the following resolution was adopted and the recommendations of the American Bar Association were endorsed in principle:

"Whereas the present high levels of Federal taxation on earned income make it virtually impossible for professional persons and other recipients of earned income to provide for their retirement from their income; and

"Whereas the problem of providing retirement benefits has to a great extent been solved for corporate employees by section 165 of the Internal Revenue Code; and

"Whereas the need for such retirement benefits is equally great in the case of professional persons and other persons having earned income but not covered by a pension plan; and

"Whereas the American Bar Association has made a special study of and has prepared legislation to be submitted to Congress aimed to make available to those persons having earned income but not covered by a pension plan; now, therefore, be it

"*Resolved*, That the Medical Society of the County of New York support, and seek to participate in, all measures that may facilitate the enactment of this proposed legislation into law; and be it further

"*Resolved*, That the Medical Society of the County of New York advise the special committee of the American Bar Association on retirement benefits for lawyers of its action; and be it further

"*Resolved*, That the Medical Society of the County of New York advise and urge State and National support of this proposed legislation by the Medical

Society of the State of New York and by the American Medical Association; and be it further

"*Resolved*, That the delegates be instructed to present the above resolution to the House of Delegates of the Medical Society of the State of New York at the annual meeting in May 1951."

Since the adoption of the above resolution, measures have been introduced by Representatives Coudert, Keogh, and Reed, and while the society is thoroughly in accord with Representative Coudert's measure in principle, we are more favorably disposed to the identical measures introduced by Representatives Keogh and Reed.

Sincerely yours,

HERBERT S. OGDEN, M. D., *Secretary*.

REQUEST BY TEACHERS INSURANCE AND ANNUITY ASSOCIATION OF AMERICA TO AMEND SECTION 22 (b) (2) (B) OF THE INTERNAL REVENUE CODE

This request is made by Teachers Insurance and Annuity Association of America, hereinafter called TIAA, a nonprofit organization with offices at 522 Fifth Avenue, New York, N. Y. TIAA serves as the medium for funding the retirement plans of more than 600 educational institutions, including most of the colleges and universities in the United States which are not under public retirement systems. Its funds presently accumulated toward retirement benefits are over $300,000,000 and it serves over 65,000 persons.

TIAA requests that section 22 (b) (2) (B) of the Internal Revenue Code be amended by inserting the language italicized below:

> "(B) EMPLOYEES' ANNUITIES.—If an annuity contract is purchased by an employer for an employee under a plan with respect to which the employer's contribution is deductible under section 23 (p) (1) (B), or if an annuity contract *providing for payments of either fixed or variable amounts* is purchased for an employee by an employer exempt under section 101 (6), the employee shall include in his income the amounts received under such contract for the year received except that if the employee paid any of the consideration for the annuity, the annuity shall be included in his income as provided in subparagraph (A) of this paragraph, the consideration for such annuity being considered the amount contributed by the employee."

This amendment is made necessary by the organization of a new agency to complement TIAA's present funding of retirement benefits. Under the existing arrangement all of the funds contributed by a college and its employees toward retirement are being invested in fixed dollar obligations to produce a guaranteed dollar income upon the individual's retirement. It is proposed that a part of these funds (not to exceed 50 percent of those for any one individual) will be placed in a new organization which will invest entirely in common stocks and other equities. The individual will be credited with units of participation in the fund, and upon his retirement the units standing to his credit will be converted on an actuarial basis into an annuity stated in terms of units rather than dollars. Each payment then made will be in the dollar value of the units at the time of payment, and will fluctuate with the total value of the fund.

This new equity fund should provide a hedge against the destructive effect inflation has upon fixed dollar retirement benefits. The possibilities of increased yield and capital appreciation in common stocks and other equities should to some extent offset any further general increases in the price level. The use of the annuity payable in terms of units will continue this hedge into the retirement period for the individual.

For tax purposes there is no significant difference between this arrangement and the present TIAA plans it is designed to complement, and the same result should be reached as now applies under section 22 (b) (2) (B) to the present college annuity plans. This basis is the same as that applicable to pension trusts, namely, that the employer's contribution is not taxable income until it is actually received as annuity payments.

The Bureau of Internal Revenue has ruled that the new method of payments does not come within the existing language of section 22 (b) (2) (B) since that section makes no express provision for payments to a retired employee that vary in amount. As a result it seems that the only means of obtaining the natural tax consequences in the situation is by amending the section as we are requesting.

Respectfully submitted,

GEORGE E. JOHNSON,
Vice President and Secretary,
Teachers Insurance and Annuity Association of America.

Statement of Charles N. Ford, Counsel, Beauty & Barber Supply Institute, Inc.

My name is Charles N. Ford. My home is in Arlington, Va., and I am engaged in private law practice at 201 Barr Building, Washington, D. C. I am appearing as Washington counsel for the Beauty & Barber Supply Institute, Inc., with principal offices at 10 West Forty-fourth Street, New York, N. Y. The Institute is a trade association representing some 650 wholesale dealers in beauty and barber supplies throughout the country. In addition approximately 320 manufacturers of beauty and barber supplies are associate members of the Institute.

This statement is submitted to the committee in support of the amendment contained in section 482 of H. R. 4473 repealing certain excise taxes imposed upon sales of toilet preparations under section 2402 of the Internal Revenue Code.

The bill would exempt from the retailers' excise tax sales of toilet preparations to the operator of a beauty or barber shop, or similar establishment, for use in the operation thereof.

TAX IS A HYBRID—IMPOSED ON SALES AT WHOLESALE

Section 2402 (b) specifically provides that the sale of such articles to beauty and barber shops for use in the operation thereof "shall be considered a sale at retail." Aside from this statute such sales are in fact wholesale. They are made in professional quantities at wholesales prices, are recognized by the industry as wholesale, and have been classified as sales at wholesale by the Wage and Hour Division of the Department of Labor. We can learn of no other instance in which the retail excise tax has been extended to cover sales at wholesale. Subsection (b) of the proposed amendment recognizes this anomaly and corrects it by stating that such a sale "shall not be considered as a sale at retail."

TAX IS ON TOOLS OF TRADE AND BUSINESS COST ITEMS

Toilet preparations used by beauty and barber shops in the performance of their services are indispensible tools of these occupations. Many services could not be performed at all without the toilet preparations subject to this tax. It is also true that they are business cost items.

The Congress has been reluctant in the past to impose excises on business cost items such as these which are passed along to the ultimate consumer and pyramided in the process. It has established even a stronger policy against imposing excises upon the tools of trade of a particular profession or occupation. There is no more justification for taxing materials used by the barber or beautician in performing his services than in taxing the leather used by the shoe repairman, the cleaning fluid used by cleaning shops, or the gold used by dentists in their profession. This tax has long been outmoded by the standards of taxation established by the Congress itself, and therefore should be repealed.

CERTIFICATE OF PURCHASE FOR RESALE SHOULD BE ABOLISHED

Under existing law, sales to beauty and barber shops for consumption therein are subject to tax, whereas sales to shops for resale are exempt from tax. To assist in collection on all taxable sales, the Bureau of Internal Revenue has imposed upon the seller, in the case of sales to shops for resale, the duty of obtaining from the purchaser a certificate of tax exemption known as a "certificate of purchase for resale." The wholesaler must report all sales monthly (showing exempt sales), keep records of exempt sales and retain the certificates of exemption on file. This burden has cost the wholesale distributors of cosmetics hundreds of thousands of dollars through the years. Since the proposed amendment would relieve the wholesaler of the duty to pay excise taxes on all sales of cosmetics to beauty and barber shops, we respectfully urge that the committee make clear in its report that the amendment is intended to eliminate the necessity of requiring the seller to obtain certificates of tax exemption from the purchaser where sales are made for resale. We believe if this is done the amendment as written will be adequate.

COLLECTION PROCEDURES PLACE SHOPS AT COMPETITIVE DISADVANTAGE

There are in round numbers 92,000 barber shops, 75,000 beauty shops, and 2,500 combined beauty and barber shops in the United States, employing a total of 157,164 persons, according to the latest census figures. These are indeed small enterprises. To the extent that they sell cosmetics at retail, they are in competition with big business—drug stores, 10-cent stores, and department stores, many of them chain store combines. But the beauty and barber shops are the only retailers of cosmetics burdened by the Bureau of Internal Revenue with the certificate of purchase for resale, bookkeeping, and reporting in connection with their purchases of cosmetics. It is significant that in spite of the fact that beauty and barber shops are natural retail outlets for cosmetics, census figures show that less than 5 percent of the shops sell cosmetics. It is reasonable to conclude that repeal of this discriminatory and burdensome collection procedure would result in increased taxable sales of cosmetics through beauty and barber shops. It would restore the shops to their rightful competitive position, give them an opportunity to augment their incomes, and offset any revenue loss that might result from repeal of the tax in question. It is of great importance to the shops, therefore, as well as the wholesalers, that the proposed amendment be approved and that the Congress in doing so make abundantly clear that the amendment is intended to eliminate the necessity for continuing the use of the certificate of purchase for resale.

SAFE DEPOSIT & TRUST CO., OF BALTIMORE,
Baltimore, Md., July 31, 1951.

Hon. WALTER F. GEORGE,
Senate Building, Washington, D. C.

DEAR SENATOR GEORGE: The revenue bill of 1951 (H. R. 4473) now before the Senate Finance Committee, contains a provision, in section 201, which has given us concern because of its effect upon people of moderate means. Our business is largely devoted to the management of estates, trusts, and agencies. A majority of the beneficiaries of these accounts are of this group. We also represent various hospitals, churches, and like charitable institutions which are exempt from tax.

This provision requires payors of interest and dividends to withhold 20 percent thereof, to be paid over to the Government and applied on account of the tax liability of the payees; but in most cases, the amounts withheld will exceed materially their tax liabilities because, for one important reason, no allowance is made for the exemptions to which they are entitled. For example, an individual who receives an income of $2,400 derived from such interest and dividends would be entitled to exemptions of $600 to $2,400, depending on age, marital status, or dependents, which would reduce materially or wipe out his tax liability. Yet $480 would be retained from his income until his return is filed in the succeeding year, and until he files and is allowed a claim for refund by the Bureau of Internal Revenue. As a result, he would be deprived of $480 (or a portion thereof) without interest for a considerable period of time. This manifestly would produce a hardship.

The same would be true of religious and charitable organizations. While it is true they would be allowed to apply social security taxes against this retention, in most cases, this allowance would afford minor relief. On the other hand, these institutions would be required to forego a large part of the income on which they rely for the maintenance of their activities.

The beneficiaries of the trusts and estates whom we represent are largely widows, dependent children, and others who cannot be gainfully employed and whose taxes would be less than the amounts retained.

If this provision is enacted into law, millions of claims from people of modest means must be handled by the Bureau of Internal Revenue; so that the process of making refunds will inevitably be delayed. These people are, as a rule, not conversant with the machinery set up by law for securing refunds; they would be required to establish to the satisfaction of the Bureau the extent of their overpayments and the items from which the retentions were made; so that the Bureau could verify the claims. In many cases they would be put to the expense of employing assistance.

While the burden of securing these refunds will, of course, fall upon the people and institutions above-mentioned, it will, in addition fall upon the banks and the trust companies to whom these people will turn for assistance; and this will occur at a time when the staffs of these institutions are reduced by enlistments and the mounting needs of defense industry. Our institution is required to prepare some 5,000 Federal and State returns each year, which will be affected by this provision. The State authorities are concerned as to the manner in which State returns reflect the retentions; and we understand that the Maryland authorities are considering the need for a detailed report to accompany the returns, to establish the correctness thereof. In our institution alone, the retentions will affect hundreds of thousands of separate items of interest and dividends.

Questions will arise as to the treatment of special cases such as stock dividends and the like which would have to be ironed out between the Treasury Department and the recipients.

When we consider the hardships which will be imposed upon the people of modest means—and they are the most numerous taxpayers—and the burdens which will be imposed alike upon the Bureau of Internal Revenue, the collectors, banking institutions, and the State taxing authorities, it is our considered belief that the injustices and the burdens on everyone concerned will outweigh the mischief at which the provision is aimed. The overwhelming majority of people make honest returns; and they and the churches and charities would be penalized because of the evasions of a minority.

We therefore respectfully ask your consideration for the elimination of this provision. The people must of necessity face the prospect of increased taxes and other privations resulting from our defense efforts; and they should not be asked to assume the additional burdens that this provision would impose.

Respectfully yours,

D. LUKE HOPKINS.

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA,
Washington, D. C., August 1, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington 25, D. C.

DEAR SIR: This is to urge your committee to reject the proposal set forth in section 493 of H. R. 4473 providing for a 3-percent tax on the transportation of oil by water in privately owned vessels.

The Independent Petroleum Association of America opposes this proposal primarily because of its discriminatory effects in the following respects:

(1) The proposal singles out the private transportation of oil and therefore is discriminatory with respect to other commodities, including competitive fuels, privately transported.

(2) The proposal applies only to transportation by water, from one point in the United States to another. It therefore is discriminatory against domestic oil in favor of foreign oil.

There are many other commodities, including competitive fuels, which are transported in large volume by water within the United States by owners of the commodities who are also the owners of the vessels used for such transportation. There has been no reason advanced which would justify the singling out of oil as section 493 proposes. The proposal is discriminatory against one commodity and against one class of consumer. It is therefore inequitable and should not be enacted into law.

There are large quantities of domestic petroleum regularly transported from the Gulf coast area to the eastern Atlantic seaboard and also large quantities which are regularly transported by water over the inland rivers and waterways. This domestic oil is in competition with imported oil. For example, that transported from the Gulf coast area to the eastern Atlantic seaboard is in direct competition with large quantities of imports from the Caribbean area and the Middle East. The proposed tax would add to the competitive disadvantage of domestic petroleum in competition with such imported oil.

In addition to the two respects mentioned above in which this proposal is discriminatory, the proposal also would involve burdensome administrative procedures which would not appear to be justified in view of the rather limited revenue derived therefrom.

We shall greatly appreciate your consideration of the association's position in opposition to this proposed tax.

Very truly yours,

RUSSELL B. BROWN.

STATEMENT BY CIGAR MANUFACTURERS ASSOCIATION OF TAMPA, FLA.

The Cigar Manufacturers Association of Tampa, Fla. (hereinafter called Tampa), is composed of 14 cigar manufacturers located in Tampa, Fla.

The Tampa association approves the statement filed this date by the Cigar Manufacturers Association of America and this statement is filed as supplementary thereto due to the peculiar position of the Tampa manufacturers.

Tampa in 1950, manufactured 231,000,000 cigars out of the total of 5,537,000,000 manufactured in the United States and its possessions. Tampa manufactured only 4.17 percent of the total manufactured.

The 14 Tampa association factories paid a total of $3,144,848 excise taxes out of the total of $42,801,301 paid by all cigar manufacturers in the United States and its possessions. Tampa paid 7.38 percent of the total paid. In other words Tampa members, on the cigars manufactured by them, paid excise taxes at the rate of almost twice that paid by the other manufacturers. Tampa's average was $13.60 per thousand and the average of the other manufacturers was $7.47 per thousand.

Tampa members manufacture cigars out of all clear Havana, imported tobacco, or out of all clear Havana filler wrapped with shade grown domestic tobacco. About 75 to 80 percent of all clear Havana and the remainder are clear Havana filler and shade wrapped.

Of the total cigars manufactured annually, approximately 100,000,000 are all hand-made, 120,000,000 are all machine-made and 12,000,000 are bunched by hand and rolled by machine. They are manufactured and sold in classes B to G inclusive of present statutory classifications.

There are only 41,000 production workers employed in the cigar-manufacturing business in the United States (Bureau of Labor Statistics for October 1950). The 14 Tampa factories employ about 4,200 of this total or approximately 10 percent of the total. Tampa employs 3,000 hand workers to make 100,000,000 all hand-work cigars and only 350 machine operators to make 120,000,000 all machine-made cigars and 180 bunch breakers to make 12,000,000 cigars rolled by machine and only 30 machine operators to roll the same. In other words, 1 cigar-machine operator on the average, makes as many cigars as 10 hand workers. Tampa is the only remaining area where cigars are made by hand for national distribution.

The Tampa association members oppose the recommended increases in cigar excise taxes and the reclassification from 7 to 10 classifications as proposed by the Secretary of the Treasury for the following reasons:

I

The Secretary of the Treasury's proposal to change the classification of cigars for revenue purposes and increase the present excise thereon is a change only in form and somewhat in amount from the proposal of the Secretary of the Treasury made to the Ways and Means Committee of the House. In that proposal instead of changing from 7 to 10 classifications as now proposed, it proposed 11 classifications.

II

The Treasury estimates its present proposal based on 1950 production would amount to $25,000,000. The total excise tax paid by cigar manufacturers in 1950 was $42,801,301. The Treasury is asking for an increase from the cigar manufacturers of approximately 60 percent, which, of course, is entirely disproportionate to the tax increase being made generally.

Based on the Tampa production in 1950, and taking into consideration transfers from present tax classifications to higher classification under the proposal, the proposed increases amount to approximately $2,350,000. Tampa, on the present rates of its 1950 production, paid $3,144,348 in excise taxes. So the increase to Tampa would amount to over 70 percent.

In June 1950, due to the economic condition of the cigar industry, the Ways and Means Committee recommended a reduction in cigar excise taxes and it was only due to the defense emergency that the same was not carried forward to legislation at that time. Conditions in the cigar industry have not improved since that time. This condition was fully gone into by the Ways and Means Committee of the House at its hearings held in March and April this year, and it did not include any increase on the Treasury's recommendation made at that time but rejected the same.

During World War II a wartime emergency tax increase on cigars was put into effect and is still effective. As a matter of fact, economic conditions in the cigar industry are in no better position than they were in June 1950 and Tampa manufacturers are not in a position to pay any additional excise taxes and the consuming public is not in a frame of mind to accept any increase in cigar prices so as to absorb additional taxes.

III

The Tampa manufacturers are not in a position to absorb any additional taxes. For the year 1949 (the latest available composite figures), the 14 association members did a gross business of $22,227,442. Their net profit thereon was only $646,169.50 before provision for income taxes or only 2.90 percent. General and administrative expense was only 4.54 percent, selling only 6.12 percent and the remainder, 86.44 percent, was actual cost of manufacturing. Their investment employed in manufacturing only, exclusive of borrowed capital, was $12,254,000. (These figures are from a composite statement compiled by a CPA from CPA audits of the individual companies.) In other words, after provision for income taxes the Tampa manufacturers made not in excess of $2 per thousand on the cigars manufactured. The figures for 1948 showed only a profit, before provision for income taxes, of 1.62 percent on a gross business of $21,352,802.57. The improvement was due to more cigar machines being put into operation.

Due to increased cost of tobacco, materials, and supplies and wage increases, the position now is no better than it was in 1949. In fact, the manufacturers, due to consumer resistance, were unable to increase prices on mnay sizes and in order to stay in the market on those sizes have been compelled to further mechanize.

In 1950 on a demand for wage increases from the union, the matter was submitted to Alfred A. Colby, arbitrator, of Washington, D. C., and in his findings and decision dated March 14, 1950, he stated:

"This arbitration could well determine whether the Tampa cigar-manufacturing industry will survive or perish and since such a heavy responsibility falls into the hands of this arbitrator, the decision is the result of a practical and realistic approach.

"It is undisputed that a surplusage of labor exists in the Tampa cigar-manufacturing industry and that the industry is at this time hard-pressed with a steadily declining market for its products and with formidable competition of machine-made production at appreciably lower manufacturing costs.

"I doubt if it (union) was aware, before the calculable costs were analyzed, that almost $1,500,000 would be added to the labor costs of the manufacturers and that in a very short time the industry's entire capital would be wiped out and that the workers would be left without means of livelihood, particularly since practically all of them are unfitted for any other occupation, and this for so many reasons unnecessary to relate."

The arbitrator granted only a few cents increase in some classifications. In the summer of 1950 the union, all production employees in all factories being members of the C. M. I. U. of A., demanded further wage increase and the parties, effective October 12, 1950, agreed on increases amounting to approximately 10 percent.

Cuban tobacco is not subject, of course, to American price controls. However, the Cuban Government does control production and also supports the price of tobacco. Tampa paid for 1950 approximately 8 percent higher than the 1949 market price. The 1951 crop now on the market is running about the same or a little higher over-all than the 1950 price.

Tampa manufacturers, in October 1950, due to increased cost of tobacco, all materials going into cigars, and wage increases granted, in an attempt to reimburse themselves, raised the price of about half of their cigar classifications. The increases did not meet all increased costs. They were unable to raise prices in other classifications due to consumer resistance. Cigars need no price ceilings as consumer resistance has already taken care of this. Due to the manner in which Tampa factories, from time immemorial, have sold their cigars to distributors, any increase in excise taxes carries an additional profit on such increase on the distributors as well as the dealers' profit margin. Cigars have always been sold at a list price which is based on the retail selling price and which price list includes the excise tax and the dealers' profit margin, which is 25 percent of his selling price, or 33⅓ percent of the cost price and includes the distributor's discount of 12 percent and 2 percent and includes the salesman's commission of 5 percent of list less the discounts. Therefore for the manufacturer to recover any increase in excise tax the list price will have to have added, in addition to the increase in excise taxes, an amount sufficient to take care of the increased dealers' mark-up, the discounts and salesman's commission. In actual practice it figures out that for each $1 of additional excise tax per thousand cigars that the retail selling price is increased $1.75 per thousand cigars. For example, if $10 additional excise is added to a class of cigars per thousand, it will be necessary for the list price to be increased to $17.50. So the selling price would have to be increased 2 cents per cigar. We call this to your attention to emphasize the fact that any increase in excise carries additional costs to the consumer and will be an additional factor in building up consumer resistance.

Due solely to the economic factor sinvolved and their economic position, the Tampa manufacturers, as much as they dislike to do so, are compelled to oppose any increase in excise taxes because they are unable to absorb the same and the consuming public will not pay the same even if the Economic Stabilization Agency grants a price increase. A heavy loss in production would result and a corresponding heavy loss in employment, particularly among the hand-made workers. Those employees, due to age and lack of other training would become subjects of Government relief. There would also be less revenue collected by the Government due to loss of production.

IV

The classification proposed by the Secretary of the Treasury is unrealistic. Its application would violate historically established business practices and principles in the industry. The application of such classification would cause some classes of cigars, due to the increased excise, to automatically go into a higher classification, thus causing such cigars to carry two increases.

The following is a table showing the present tax and the Treasury-proposed tax on present retail prices:

Retail price (cents)	Present tax	Proposed tax	Increase in rate
Not over 2½	$2.50	$3.00	$0.50
Over 2½ to 4	3.00	3.00	....
Over 4 to 6	4.00	5.50	1.50
Over 6 to 8	7.00	9.00	2.00
Over 8 to 10	10.00	12.00	2.00
Over 10 to 12	10.00	15.00	5.00
Over 12 to 14	10.00	18.00	8.00
Over 14 to 15	10.00	21.00	11.00
Over 15 to 16	15.00	21.00	6.00
Over 16 to 18	15.00	24.00	9.00
Over 18 to 20	15.00	27.00	12.00
Over 20	20.00	32.00	12.00

As shown by the above table, cigars now retailing at over 8 cents and up to 15 cents carry one classification and pay one rate. The Treasury has broken this down into four classifications, paying four different rates, and increasing the rates from $2 to $11 per thousand. Under present rates, cigars retailing at over 15 cents up to 20 cents pay $15, and the Treasury's proposal breaks this into three classifications paying from $21 to $27 and making increases from $6 to $12. To show how unrealistic it is, for example, the increase on a cigar now selling at over 14 cents and up to 15 cents is $11, while one selling at over 15 cents to 16 cents is $6, while cigars retailing at over 12 cents up to 14 cents are increased $8. We have explained above how Tampa sells its cigars, namely, the list price is the retail price of cigars and it is on this price that the brokers, dealers, and salesmen's commissions are based. Therefore, in order for the manufacturer to recover any increase in excise tax he has to increase an additional amount to take care of these profits. In other words, every dollar in increased tax figures out $1.75 in the list price of cigars. Therefore, under the Treasury's proposal, for example, for cigars now retailing at 15 cents, therefore if the proposed increase of $11 is granted the price of the cigar would have to be increased $20 per thousand or 2 cents per cigar, then this present 15-cent cigar would have to be priced at 17 cents and it would put this cigar then in the Treasury's bracket of cigars selling at over 16 cents and up to 18 cents, where there would be an additional increase in revenue of $3 over the $11. The same applies to the Treasury's proposal in other brackets, particularly in cigars now selling at over 12 cents and up to 14 cents and cigars now selling at over 16 cents and up to 18 cents and cigars now selling at over 18 cents and up to 20 cents. So it can readily be seen what such a result would be with the consumers.

There is nothing which indicates that the Treasury's proposal will bring in any additional revenue to the Government. The history of the cigar business for the last 2 or 3 years all indicates that if the proposal is put into effect revenue from cigars will decrease, will cause hardship to manufacturers and to their employees.

Administratively such classifications would cause great hardship and additional expense to the Government and the manufacturers. Our factories pack some classes of cigars in boxes of both 25 and 50 per box. Each pack for each classification requires a different stamp. Some of our factories would have to carry and affix as many as 14 different stamps.

We respectfully request that the proposal of the Secretary of the Treasury be denied both as to increases in excises and change in classification.

Respectfully submitted.

CIGAR MANUFACTURERS ASSOCIATION OF TAMPA,
By FRANCIS M. SACK, *Secretary*.
BROWN, BROWN & CORCORAN,
By RAY C. BROWN,
Attorneys for Cigar Manufacturers Association of Tampa.

BRIEF OF R. J. REYNOLDS TOBACCO CO.

ADJUSTMENT FOR CHANGES IN BORROWED CAPITAL DURING THE TAX YEAR

Section 435 (a) (1) of the Internal Revenue Code provides that the excess-profits credit—based on income—of domestic corporations is increased by 12 percent of the net capital addition for the taxable year and is decreased by 12 percent of the net capital reduction for the year. The net capital addition and reduction are determined under section 435 (g).

Under section 435 (g), in determining the net capital addition for the taxable year, there is included 75 percent of the amount by which the taxpayer's average borrowed capital for the year exceeds its borrowed capital as of the beginning of its first taxable year. Similarly, in determining the net capital reduction for a taxable year, there is included 75 percent of the amount by which the borrowed capital at the beginning of the taxpayer's first taxable year exceeds its average borrowed capital for the year.

Borrowed capital of a corporation may vary greatly during the course of its taxable year. In the case of some corporations, borrowed capital is at its minimum at the beginning of the taxable year and in the case of others may be at its maximum. Section 435 (g), in requiring that determination of increases or decreases in borrowed capital occurring during a year be made by comparison of average borrowed capital for the year with borrowed capital at the beginning of the first taxable year, favors those corporations which had minimum borrowings at the beginning of their first taxable year and discriminates against those corporations having maximum borrowings at the beginning of their first taxable year.

The business of R. J. Reynolds Tobacco Co., which is a corporation manufacturing and selling tobacco products, necessitates that it purchase each year large quantities of leaf tobacco during the season when such tobacco is sold by the growers. This season generally starts in July and ends in the following January or February. Large sums of money are required for the purchasing of tobacco and as an aid in financing the acquisitions the company for many years has made borrowings on a short-term basis. The peak of these borrowings occurs at the end of the leaf-buying season and approaches its maximum on January 1, the first day of the company's taxable year. Consequently, normally the company's borrowed capital at the beginning of the year far exceeds its average borrowed capital for the year. Thus, on January 1, 1950, the company's borrowed capital exceeded its average borrowed capital for that year by over $15,000,000. In 1949, the borrowed capital at the beginning of the year exceeded the average borrowed capital for the year by over $32,000,000.

Because the average borrowed capital of the company for the year was some $15,000,000 less than its borrowed capital at the beginning of 1950, the company's excess-profits credit for that year was decreased by approximately $1,850,000.

The act in recognizing the necessity for adjustment of the excess-profits credit for increases or decreases in invested and borrowed capital occurring subsequent to the base-period years is unquestionably sound. However, the method of determining such adjustment is inequitable and discriminatory. The earnings of a corporation for any particular year are not dependent on its capital and borrowings at the beginning of the year but on the use of capital and borrowings during the entire year. Thus, the only fair approach in determining increases or decreases in capital and borrowings for the purposes of the excess-profits-tax law is by comparing the average capital and borrowings for the particular year with the average for the period as against which the comparison is being made. With particular respect to borrowed capital, the test, therefore, should be a comparison of the average borrowed capital for the tax year with the average borrowed capital of the last year in the base period.

ADJUSTMENT FOR BASE PERIOD CAPITAL ADDITIONS

With respect to the adjustment for base period capital additions provided for in section 435 (a) (1) (B), a similar inequity exists in the method of computing increases in borrowed capital and capital additions in the various years of the base period. While for base-period purposes the comparisons for the respective years are consistently made on the basis of capital as it existed at the beginning of each year, such comparisons, limited as they are to a single day in a year, do not measure the difference in true capital used for the various years.

In October 1948 the company obtained $20,000,000 in new capital as the result of the issuance of preferred stock. This additional capital, since it was added in the last months of 1948 and not in 1949, is recognized for the purposes of determining base-period capital additions only to the extent of 50 percent. If this financing had been postponed for only 3 months so that it occurred in the first part of 1949, it would have been recognized at 100 percent. As the financing occurred late in 1948, it had little effect on the earnings for that year.

Since, as previously stated, a corporation's earnings are normally dependent on the use of capital funds throughout the entire year, in computing additions to capital during the base-period years, equity requires that the comparisons of 1 year as against the other be on the basis of the average invested capital and borrowed capital for each year rather than such capital at the beginning of each year.

CONCLUSION

In order to eliminate such inequities and discriminations in computing the excess profits credit—based on income—it is respectfully submitted that section 435 should be amended as follows:

1. As to base-period capital additions, the yearly base period capital should be determined by adding to the equity capital as it existed at the beginning of the year the average daily amount of new capital (excluding earned surplus additions) for the year and 75 percent of the average daily borrowings for the year, less reductions for inadmissible assets, loans to members of a controlled group and interest, all computed on an average basis.

2. As to net capital additions for taxable years, these should be determined by adding to the equity capital as it existed at the beginning of the year the average daily amount of new capital (excluding earned surplus additions) for the year and 75 percent of the average daily borrowings for the year, with appropriate adjustment for inadmissible assets and loans to members of a controlled group, computed on an average basis. To the extent the capital thus determined exceeds or is less than capital similarly determined for the last year of the base period, 1949, the credit for the year should be increased or decreased, as the case may be, by 12 percent of the amount.

Respectfully submitted.

R. J. REYNOLDS TOBACCO CO.,
By H. H. RAMM, *Solicitor.*

COMMITTEE ON TAXATION OF THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK,
New York, August 3, 1951.

Hon. WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

DEAR SENATOR: The committee ontaxation of the Association of the Bar of the City of New York desires to invite to the attention of each member of the Senate Committee on Finance three points which our committee believes should have consideration at this time:

(*a*) Proposals to stabilize restricted stock options.

(*b*) Retroactive applications of section 211 of the Revenue Act of 1950 relating to short sales.

(*c*) Proposed withholding on the gross amount of royalties under section 201 of the revenue bill of 1951 (H. R. 4473).

A brief discussion of each of these points follows.

A. PROPOSALS TO STABILIZE RESTRICTED STOCK OPTIONS

Largely as a result of the efforts of your committee, Congress in the Revenue Act of 1950 gave statutory recognition to the fact that certain types of employee stock options, called restricted stock options, were not compensatory.

The Salary Stabilization Board, however, has appointed a stock option panel to hold hearings and make recommendations as to whether employee stock options, including restricted-stock options, are subject to stabilization under the Defense Production Act of 1950. The Board has cautioned employers against granting such options until the issue is determined, and there are indications that on the staff level the issue may have been resolved in favor of stabilization of all employee stock options.

Under the circumstances our committee recommends the adoption of legislation, believed to be declaratory of the present law, to make it clear beyond dispute that restricted stock options conforming to section 130A are not compensatory and, therefore, are not subject to stabilization. This legislation is considered necessary in order to prevent administrative bodies from frustrating the use of restricted stock options as noncompensatory incentive devices despite the will of Congress expressed in section 130A.

We consider it clear as a matter of statutory construction that restricted stock options are not subject to stabilization. The exercise of taxpayers' rights should not, however, unlawfully be obstructed and delayed by administrative agencies and their extrastatutory panels for lack of a clear legislative expression on the issue.

Section 402 (b) (1) of the Defense Production Act of 1950 authorizes the President to "issue regulations and orders stabilizing wages, salaries, and other compensation." The question raised is whether stock options, more particularly stock options conforming to section 130A of the Internal Revenue Code, constitute "other compensation" subject to stabilization.

Section 702 (e) of the Defense Production Act, contains the following further statutory definition.

"The words 'wages, salaries, and other compensation' shall include all forms of remuneration to employees by their employers for personal services, including, but not limited to, vacation and holiday payments, night shift and other bonuses, incentive payments, year-end bonuses, employer contributions to or payments of insurance or welfare benefits, employer contributions to a pension fund or annuity, payments in kind, and premium overtime payments."

The committee reports and hearings in connection with the Defense Production Act do not expressly consider whether restricted stock options are subject to stabilization as "other compensation." The foregoing definition, however, was added to the act by Senate amendments to H. R. 9176 on August 21, 1950. On the following day your committee reported to the Senate the revenue bill of 1950, H. R. 8920, first introducing the detailed provisions with respect to restricted stock options. The two bills were considered concurrently by both Houses. It is clear as a matter of legislative history that the key to the application of the Defense Production Act to stock options is to be found in the Internal Revenue Code and particularly in section 130A thereof.

The concept of "wages, salaries, and other compensation" dealt with in the Defense Production Act of 1950, is identical with that contained in the Internal Revenue Code. The general definition of "income" is contained in section 22(a) of the Internal Revenue Code. It provides in part:

"'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind, and in whatever form paid * * *."

It has been recognized that Congress thereby intended to include in income compensation in its most comprehensive sense. In *Commissioner* v. *Smith* (324 U. S. 177 (1945)), the Supreme Court said:

"Section 22(a) of the revenue act is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected" (p. 181).

There is nothing in the legislative history of the Defense Production Act to indicate that Congress could have intended a broader definition of "compensation" than that included in the Internal Revenue Code. The identity of basic concept in the two statutes and the interrelation of the statutes is also evidenced by the intended use of disallowances of income-tax deductions as sanctions for enforcement of wage stabilization (sec. 405 (b); S. Rept. No. 2250, 81st Cong., 2d sess. 39 (1950)). Stabilization of restricted stock options is patently inconsistent with this provision, for the employer receives no deduction for a restricted stock option.

The significant characteristic common to each type of compensation itemized in the definition of wages, salaries, and other compensation contained in section 702 (e) of the Defense Production Act is that it is by nature taxable as income. (Cf. U. S. Treasury Reg. 116, sec. 405.101 (1949), defining wages for withholding purposes.) Employer contributions to a pension fund is an apparent exception only because Congress there by statute expressly relieved from taxation payments which otherwise would be taxable to the employee. Under accepted rules of statutory construction, restricted stock options should be included in the term "wages, salaries, and other compensation," subject to stabilization, only if by nature they are taxable as income.

Under section 130A the granting of restricted stock options does not give rise to taxable income. More significant, however, is the fact that it is clear from the legislative, judicial, and administrative history of stock options that the enactment of section 130A did not change the preexisting law in this respect. It merely gave statutory definition to those stock options which never had been compensatory and never had been taxable as income.

A bargain purchase does not in itself give rise to the receipt of taxable income. When granted by an employer to an employee the option may be of such nature as to be compensatory. But courts, before and since the Smith case, have recognized that incentive stock options are not compensatory and do not give rise to ordinary income. (For example, Delbert G. Geeseman, 38 B. T. A. 258 (1938), acq. 1939—1 C. B. 13; Norman G. Nicholson, 13 T. C. 690 (1949).)

The Government conceded in its brief before the Supreme Court in the Smith case that an employee stock option would not give rise to compensation "where the sole purpose is to insure the employee's unflagging loyalty by giving him a stake in the employer's business" (p. 11). The Government also there stated—

"The governing Treasury regulations providing that where property is transferred by an employer to an employee for an amount substantially less than its fair market value, the employee shall include the difference in his gross income *to the extent that it is in the nature of compensation for services*, express well settled principles, are of long standing, and must be deemed to have congressional approval" (p. 22). [Italics supplied.]

The Treasury Department thought it found in the Smith opinion authority for the proposition that every employee stock option was compensatory, and amended its income tax regulations accordingly. Your committee corrected this impression, however, in its report accompanying the Revenue Act of 1950 wherein it said:

"Moreover, your committee believes these regulations go beyond the decision of the Supreme Court in *Commissioner* v. *Smith* (324 U. S. 177 (1945). Rept. No. 2375, 81st, Cong., 2d sess. 59 (1950))."

Section 130A is therefore to be recognized as merely congressional definition of the existing line between compensatory and noncompensatory options. Because of the identity of concept in the stabilization and income-tax statutes, this statutory definition should be controlling for both purposes. Legislative clarification seems necessary, however, in order to prevent administrative interpretation from again blurring the lines so recently drawn.

The intended operation of section 130A was described in your report as follows:

"Under your committee's bill no tax will be imposed at the time of exercise of a 'restricted stock option' or at the time the option is granted and the gain realized by the sale of the stock acquired through the exercise of the option will be taxed as a long-term capital gain. Such treatment is limited to the 'restricted stock option' for the purpose of excluding cases where the option is not a true incentive device." (S. Rept. No. 2375, 81st Cong., 2d sess. 60 (1950)).

Section 130A(b), relating to so-called 85 percent options, specifies the very limited extent to which restricted stock options shall be "included as compensation." Section 402(d)(2) of the Defense Production Act expressly provides that no action shall be taken with respect to wages, salaries or other compensation which is inconsistent with any other law of the United States. The Salary Stabilization Board is thus devoid of statutory authority to adopt regulations subjecting restricted stock options generally to stabilization as "other compensation," but legislation is nevertheless necessary to remove the threat.

In recommending such legislation our committee would like to point out that stabilization of restricted stock options is not only inconsistent with section 130A but is entirely unjustified by the purposes of the Defense Production Act. Restricted stock options are not inflationary. The grant of such an option places no funds in the hands of the optionee. The exercise of the option requires substantial investment by the optionee, thereby shrinking the funds in the hands of consumers for inflationary spending. These funds will not be released for extended periods of time, probably far outlasting the temporary stabilization legislation. Stock acquired under options granted today cannot be sold prior to August 1953, without loss of the benefits of section 130A. The extended option periods of restricted stock options already granted suggest that exercise and sale will in practice be much longer deferred. (See Wall Street Journal, July 9, 1951.)

If the Salary Stabilization Board, despite its lack of jurisdiction, were to attempt to stabilize restricted stock options, endless administrative confusion would result. If restricted stock options are held to result in compensation when granted, the problems of valuation at that date are well nigh insuperable. If the extent of compensation is not to be measured until the option is exercised, it becomes impossible to regulate the present granting of the option.

There is a clear need for clarifying legislation to avoid the return of confusion to the field of stock options and to forestall unwarranted administrative interference with the operation of section 130A as intended by Congress. To this end our committee recommends that section 130A(a)(1) be amended to read as follows:

"(1) for the purposes of this title and of any other law of the United States, no income or compensation for personal services shall result at the time of the grant of such option or the transfer of such share to the individual upon his exercise of the option with respect to such share;".

B. RETROACTIVE APPLICATIONS OF SECTION 211 OF THE REVENUE ACT OF 1950 RELATING TO SHORT SALES

Section 211 of the Revenue Act of 1950 enacted certain rules to be followed with respect to short sales. Although the legislation was expressly limited to transactions in taxable years beginning after the date of enactment, the Bureau of Internal Revenue is currently applying these rules to commodity futures transactions in earlier years. Our committee feels that this situation calls either for a new expression of intention by your committee or for corrective legislation.

In mimeograph 6243, dated March 8, 1948, the Bureau of Internal Revenue notified its field officers that concurrent long and short positions in the same commodity in the same market for delivery in the same contract period are considered closed when the offsetting trade is first made. Congress has now given legislative authority to the contention of taxpayers that mimeograph 6243 does not properly reflect the law existing prior to the change made by the Revenue Act of 1950.

Section 211 of the Revenue Act of 1950 gave prospective statutory force to the rules which mimeograph 6243 had attempted to impose prior thereto. In procuring this legislation full recognition was given by the congressional committees to the fact that under then-existing law taxpayers were entitled to the tax advantages which section 211 would thereafter deny.

The report of your committee said:

"At the present time it is possible for an investor in stocks to realize a capital gain in less than 6 months and obtain long-term capital-gain tax treatment on it by making a short sale, which will assure his gain on his original investment, and then defer closing out the short sale until he has held his original stock investment for more than 6 months. A similar result may be obtained where the initial transaction is a short sale.

"Much the same device may be used by a taxpayer to avoid tax on his profits from speculation in commodity futures. * * *" (S. Rept. No. 2375, 81st Cong., 2d sess. 44 (1950)).

Prior to the issuance of mimeograph 6243 the Bureau of Internal Revenue itself had long recognized that with respect to commodity transactions the law was contrary to the position therein taken. (E. g., unpublished Bureau rulings dated December 14, 1943, and March 10, 1947.) And in the case of security transactions, concurrent long and short positions prior to 1950 are still recognized for tax purposes. (G. C. M. 7451, IX-1 C. B. 81 (1930); Robert W. Bingham, 27 B. T. A. 186 (1932), Acq. XII—1 C. B. 2.)

Mimeograph 6243 is thus contrary to law existing prior to enactment of the Revenue Act of 1950 as viewed in congressional committee reports, former Bureau rulings, and court decisions. The Bureau of Internal Revenue is nevertheless currently applying mimeograph 6243 to transactions in taxable years beginning prior to enactment of the Revenue Act of 1950, and even to taxable years prior to the issuance of the mimeograph. Taxpayers have contested this action in more than a dozen petitions now docketed with the Tax Court, the first of which, docket Nos. 31057 and 31058, are scheduled for hearing in October.

The Bureau's attempt to apply the rules retroactively to transactions which occurred in taxable years beginning before September 23, 1950, under the guise of following an administrative ruling, would be in violation of the express provisions of section 211 (b) of the Revenue Act of 1950. Section 211 (a) adds to the code section 117 (l), which commences: "In the case of a short sale of property made by the taxpayer after the date of enactment of the Revenue Act of 1950:" Section 211 (b) provides "EFFECTIVE DATE.—The amendment made by this section shall be applicable only with respect to taxable years beginning after the date of enactment of this act."

Congress was well aware of the existence of mimeograph 6243, since both committee reports refer to it (S. Rept. 2375, 81st Cong., 2d sess. 87 (1950); H. Rept. 2319, 81st Cong., 2d sess. 96 (1950)). Section 211 (b) does not, however, contain any provision against the drawing of inferences from nonretroactivity such as that contained in the following section, section 212, relating to collapsible corporations. As a matter of statutory construction, therefore, it should be inferred that transactions prior to the effective date of the short sales provision should be treated differently than those which followed it.

As further evidence, your committee's report on section 211 contains the following passage:

"The amendments made by this section are applicable only with respect to taxable years beginning after the date of enactment of the bill. Even with respect to such taxable years, however, the amendments do not apply where the short sale was made on or before the date of enactment of the bill" (S. Rept. 2375, 81st Cong., 2d sess. 88 (1950).

Your committee thus carefully excluded from the effect of the amendment short sales initiated before its effective date, even though substantially identical property was acquired after such effective date and before closing of the short position. Congress clearly cannot have contemplated a continuing application of mimeograph 6243 to transactions occurring before the effective date of the amendment, thus obliterating the distinction your committee took pains to point out.

Because of the Bureau's persistence in the continued application of mimeograph 6243 despite the apparent contrary intent of Congress, it is recommended that your committee give new expression to this intent, by legislation or otherwise.

C. PROPOSED WITHHOLDING ON THE GROSS AMOUNT OF ROYALTIES UNDER SECTION 201 OF THE REVENUE BILL OF 1951 (H. R. 4473)

Section 201 of the revenue bill of 1951 (H. R. 4473) provides for withholding at source of 20 percent of the gross amount of dividends, interest, and royalties paid. Section 1220 (a), to be added to the Internal Revenue Code, defines "royalties" to include royalties in respect of mines, oil and gas wells, and other natural deposits. The definition appears to include the landowner's royalty, overriding royalties, and oil and gas payments.

Section 201 fails to give any recognition to the fact that such royalties, as contrasted with dividends and interest, are the fruits of a wasting asset. For tax purposes, a portion of each payment constitutes a return of the capital investment of the owner of the mineral deposit and to that extent does not constitute taxable income. This capital recovery is represented by the cost-depletion allowance or, where higher, by statutory percentage depletion.

To require a withholding of 20 percent of the gross royalty paid without recognition of the depletion allowance will thus result in a substantial overwithholding of tax on the taxable income actually involved. Many royalties and oil payments have been purchased by investors after the approximate extent of the oil reserve and duration of the payments have been ascertained. In such cases the risk is small and the capital invested represents a large part of the total recovery to be received over the years. For example, if an investor purchased on a 6-percent discount basis a $500,000 oil payment expected to pay out ratably over 5 years, his purchase price would be $421,000. He would receive payments of $100,000 each year, of which $15,800 would represent taxable income and $84,200 a return of capital. If 20 percent of the gross payment is withheld as tax, the withholding would absorb 100 percent of the income and 5 percent of the return of capital as well.

This overwithholding in many cases will work a great hardship on the taxpayers involved even though tax refunds will ultimately be received. Royalties and oil payments in very substantial amounts have been assigned to institutional lenders as security for borrowing, and the reduction of 20 percent in the amounts immediately applied to the loans may result in defaults.

To a lesser extent, the problem above referred to exists in the case of royalties on patents, copyrights, trade-marks, etc., which are included in the definition under proposed section 1220(b) of the Internal Revenue Code. In these cases, the capital investment is recoverable by way of depreciation rather than depletion. As in the case of mineral royalties, however, the taxpayer will not be taxed on the entire royalty.

Normally it is not possible for the withholding agent to ascertain the portion of the royalty which would be taxable to the recipient. Because of the administrative difficulty which this presents, our committee recommends against the extension of withholding at source to royalties. If such withholding is to be required, however, it recommends that legislation be adopted permitting taxpayers to obtain a quick refund of amounts withheld on royalties. Such refunds would be based on the taxpayer's estimate of the depletion or depreciation allowance to which he is entitled.

Respectfully submitted.

COMMITTEE ON TAXATION OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK.
By JOHN P. OHL, *Chairman*.

NEW JERSEY GUERNSEY BREEDERS' ASSOCIATION, INC.,
New Brunswick, N. J., July 31, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: I am president of the New Jersey Guernsey Breeders' Association that comprises the great majority of all the pure-bred Guernsey breeders and milk producers in the State of New Jersey.

We have been discussing the various interpretations that the Internal Revenue Department seems to have placed in the past on the revenue acts as passed by Congress. It is our understanding that the Senate Finance Committee, of which you are chairman, is now considering the new Revenue Act of 1951, and we would like to direct ourselves to one provision of the bill (H. R. 4473) as it was passed by the House.

This provision is of vital interest to our members, as well as to the countless taxpayers throughout the country who have herds of animals used for draft, breeding, or dairy purposes. It is our understanding that section 306 of the bill reads as follows:

"Effective with respect to taxable years beginning after December 31, 1950, section 117 (j) (1) is hereby amended by adding at the end thereof the following new sentence: 'Such term also includes livestock held by the taxpayer for draft, breeding, or dairy purposes for 12 months or more.'"

It would seem to us that the intention of the provision was to make sure that the taxpayer shall receive a capital gains treatment when he sells draft, breeding, or dairy livestock, with the requirement that to secure such treatment the livestock must have been "held by the taxpayer" for such purposes for 12 months or more.

You and your committee must be familiar with the past confusion of the taxability of sales of draft, breed, and dairy animals. Despite the fact that an interpretation of the language of the past law and the fact that judicial decisions have been to the contrary, the Commission of Internal Revenue for the past few years has changed their decision and are now holding that sales of such animals result in ordinary income. Last year your honorable committee was most cognizant, we believe, of this situation when it considered the insertion of a provision on this subject in the Revenue Act of 1950 which spelled out just what you meant by the language it contained. However, for certain reasons this was not done and I call your attention to the conference committee report (H. Rept. No. 3214, 81st Cong., 2d sess., p. 28) which said: "It is the hope of the conferees that, pending such study and further legislation, the Treasury Department will follow the decision of the Eighth Circuit Court in the *Albright Case* (173 F. 2d 339)."

Since then, the Treasury Department has come out with a new position set forth in mimeograph 6660 (June 27, 1951), but in this ruling the Commissioner still has not gone as far as some of the court decisions.

Obviously, and especially in view of what happened last year, the intent behind section 306 of the pending revenue bill is to afford taxpayers certain benefits and to make sure that they receive them, notwithstanding what the position of the Commissioner may be.

However, we would like to point out to you that the language in the bill lacks clarity and could very well result in considerable litigation which would be costly to taxpayers, as well as the Government, and which might very well defeat the intent of this new legislative provision. While the language to be added to section 117 (j) refers to livestock "held by the taxpayer" for 12 months or more, there is no way of determining when such holding period begins. The report of the House Committee accompanying this bill (H. Rept. No. 586, 82d Cong., 1st sess.) sheds no light on this at all. It states:

"Your committee believes that the term 'livestock' in this new sentence should be given a broad, rather than a narrow, interpretation; and that the gains from sales of live stock should be computed in accordance with the method of livestock accounting used by the taxpayer and presently recognized by the Bureau of Internal Revenue."

To give you a specific example, let us refer to a bull which is owned by the owner of a dairy herd. The bull cannot be used for breeding until it is from 10 to 12 months old. When does a taxpayer begin to hold such an animal for breeding purposes? If the bull was born on taxpayer's farm and the taxpayer did not sell it to the butcher after a few weeks, but held it in the herd, incurring the resulting expense awaiting the time when the animal can be used for breeding, it seems to us quite clear that once the bull has passed 1 month of age, the taxpayer begins holding it for breeding purposes.

The same is true with regard to a heifer calf. It would not be bred until about 18 months of age and would first drop a calf about 9 months thereafter. Yet, once a month or so has gone by after the birth of this heifer calf, with the taxpayer not selling it but holding it in the herd, with the attendant expenses, taxpayer is holding such animal for dairy or breeding purposes.

In order to avoid confusion and considerable and costly litigation in the future, and in keeping with the apparent intent behind this provision, it is requested that your honorable committee modify this language so as to make it crystal clear when the holding period begins.

Knowing how busy your committee is, with numerous witnesses requesting permission to appear before it, we are attempting to cooperate with you and are confining our request to the form of this letter. We trust you will be good enough to see to it that it receives the attention of yourself and your honorable committee. If you or your committee so desire, we would be glad to personally appear before it to discuss this particular subject at greater length.

Thanking you for your consideration.

Respectfully,

ATHERTON W. HOBLER.

AMERICAN MEDICAL ASSOCIATION,
Chicago 10, July 31, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: In compliance with the promise contained in my telegram to you yesterday, I am enclosing copies of resolutions considered by our house of delegates at its Atlantic City meeting in June of this year, and the action taken on them, relating to retirement benefits for professional persons who are self-employed. I shall appreciate it if this material be incorporated in the hearings on the Ives amendment to H. R. 4473.

I am also enclosing a copy of a statement prepared by the director of our bureau of medical economic research, Frank G. Dickinson, Ph. D., entitled "Income Tax Discrimination Against the Professions." I think this statement will clearly indicate the interest of medicine in the Ives amendment and I hope that the statement can be included in the record of the hearings now under way.

Sincerely yours,

ERNEST B. HOWARD.

RESOLUTIONS ON RETIREMENT BENEFITS FOR PROFESSIONAL PERSONS

Dr. W. P. Anderton, New York, presented the following resolutions, which were referred to the reference committee on legislation and public relations:

"Whereas the present high levels of Federal taxation on earned income make it virtually impossible for professional persons and other recipients of earned income to provide from this income for retirement; and

"Whereas the problem of providing retirement benefits has to a great extent been solved for corporate employees by section 165 of the United States Internal Revenue Code; and

"Whereas the need for such retirement benefits is equally great in the case of professional persons and other persons having earned income but not covered by a pension plan; and

"Whereas the American Bar Association has made a special study and has prepared legislation to be submitted to Congress aimed at making available retirement benefits for those persons having earned income but not covered by a pension plan; therefore be it

"*Resolved*, That the House of Delegates of the American Medical Association urge the board of trustees to support and seek to participate in all measures that may facilitate the enactment of such legislation into law; and be it further

Resolved, That this House of Delegates approve in principle United States House of Representatives bill No. 3456, introduced by Mr. Frederic R. Coudert, Jr., Seventeenth District, New York."

REPORT OF REFERENCE COMMITTEE ON LEGISLATION AND PUBLIC RELATIONS

Dr. L. G. Christian, chairman, submitted the following report which was duly adopted:

"Your reference committee has given careful consideration to the three resolutions referred to it relating to pension plans for physicians, introduced by Dr. Huron, of Michigan; Dr. Anderton, of New York; and Dr. Stovall, of Wisconsin. Since all of these resolutions deal with the same subject matter, they were considered jointly.

"The objective sought is to establish a procedure whereby physicians and members of other professional groups may during their most productive years provide for their old age and less productive years by the purchase of retirement benefits with tax-deferred income, the benefits being taxable when received. Such a procedure is presently available for the benefit of employees and officers of corporations but not to taxpayers who are self-employed.

"The board of trustees in February 1948 gave consideration to a somewhat similar proposal and approved it in principle. At a subsequent meeting of the house of delegates, also in 1948, the action of the board was expressly commended by the House. Since that time the directors of the Bureau of Medical Economic Research and of the Bureau of Legal Medicine and Legislation have had a number of conferences with representatives of the American Bar Association and of the Association of the Bar of New York City in an effort to develop appropriate legislation for presentation to Congress. Your reference committee has been informed that the draft of legislation being prepared by a special committee of the American Bar Association is approaching final form which will be introduced in the Congress in the near future.

"There have been introduced in the Congress from time to time a number of bills dealing with this subject. There are now pending the bill referred to in the New York resolution, H. R. 8456, and another introduced within the last several days. Your reference committee does not believe it timely for the House to express its support of any particular bill. It does recommend that the House reemphasize its 1948 endorsement of the principle embodied in this proposal, with a reasonable ceiling on the amount of the retirement benefit and that the board of trustees be requested to continue its efforts in support of this principle, giving special consideration to any legislation formulated by the American Bar Association."

[Reprinted from the Journal of the American Medical Association, April 29, 1950, vol. 142, pp. 1357-1360]

BULLETIN 74—INCOME-TAX DISCRIMINATION AGAINST THE PROFESSIONS[1]

(By Frank G. Dickinson, Ph. D., director, Bureau of Medical Economic Research, American Medical Association)

Under section 165 (a) and related sections of the 1942 Federal Internal Revenue Code, funds used by companies for the purpose of providing employees with pensions or shares in profit-sharing trusts are deductible from gross receipts as business expenses and thus are not a taxable part of the employer's or company's income, if the particular plan is approved by the Bureau. These funds do not become a taxable part of the recipient's income until they are actually received, either when the recipient retires or when he cashes in on his profit-sharing account—at which time he will presumably be in a lower-income bracket. Since the provisions of section 165 (a) and related sections are restricted to employees, professional men who can qualify as employees—for example, company lawyers and company physicians—can receive the benefits of these pensions and profit-sharing trusts, while those who conduct their professions as single proprietorships or partnerships may not qualify for these benefits. The income-tax discrimination, which is particularly burdensome to professional men who practice as individual proprietors and partners, is the subject of the following discussion.

THE PROBLEM—ITS ORIGIN

Until 1935 the problem of financing the retired years of life has been left largely to private initiative, although a few States had enacted pension laws prior to that date. The Social Security Act of 1935 embodied a new doctrine of individual irresponsibility, or social responsibility; society through Government would provide minimum benefits for the aged. The Social Security Act, however, because of its limitations and exclusions, introduced certain glaring inequities.

The old-age and survivors' insurance sections of this act provide for employee pensions financed by equal taxes paid by employer and employee on the portions of annual salaries not in excess of $3,000. Employers pay their share out of gross receipts. Their payments, as costs of doing business, are income tax free. Employees, on the other hand, cannot deduct their contributions for income-tax purposes, but the pensions, when received, are not subject to Federal income taxes. The effect of the act was to provide proportionally greater benefits for those with incomes below $3,000 than for those with incomes above $3,000. Before the new social theory could become properly integrated with our way of life, an inequity such as this had to be eliminated.

Section 165 (a) and related sections of the 1942 Federal Internal Revenue Code provide for additional pensions or shares in profit-sharing trusts on the basis of total income, not just that portion under $3,000. Although these additional pensions and profit-sharing plans largely benefit those with incomes of less than $3,000, I firmly believe that section 165 (a) and related sections were primarily designed to round out the program first introduced in an incomplete form in the

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[1] This discussion is based on a paper read at a symposium on medico-legal problems in the fall of 1948. The symposium was jointly sponsored by the Chicago Bar Association, the Chicago Medical Society, and the Institute of Medicine of Chicago.

depression-born Social Security Act in that they provide more equitable treatment for those with incomes above $3,000 in an era of steeply progressive income-tax rates. Since the code's provisions, however, are restricted to employees including executives of corporations, those who conduct their businesses or professions as single proprietorships or partnerships are excluded. Thus all single proprietors or partners—farmers, shopkeepers, professional men—suffer this income-tax discrimination.

The very nature of professional work and training makes this discrimination a particular hardship for professional men. The total lifetime income taxes paid by a professional man on a lifetime income may greatly exceed those paid by a nonprofessional person on the same lifetime income, because the former has a long training period and his high earnings are bunched into a relatively small number of peak earning years. Those professional men who can qualify as employees under section 165 (a) of the Federal Internal Revenue Code—for example, company physicians or company lawyers—receive more reasonable treatment. Their employers can set aside funds for pensions which, as already noted, are deductible from company income as business expenses and therefore are not a taxable part of employer or company income. Section 165 (a) and related sections also provide that these funds are not subject to individual income taxes as a part of the recipient's income until he actually receives them, either on retirement or when he cashes in on his profit-sharing account. Thus the real benefit to the salaried professional man is derived from the postponement of the payment of taxes on his income until a time when his income, and therefore his tax rate, is expected to be lower. The realization of this benefit, of course, hinges on the income-tax laws at the time the cash is received as well as on the individual's income at that time.

THE CASE FOR PHYSICIANS

Since my work is most closely associated with the medical profession, I shall discuss their particular situation. Important in evaluating income-tax policies affecting the physician is a knowledge of the unusual pattern of his economic life. First, consider the cost of becoming a physician. The prospective physician typically spends at least 3 years in premedical training and 4 years in a medical college—a total of 7 years. Almost all graduating doctors of medicine today spend a year in internship. During this year the physician receives board and room and sometimes a nominal salary. The year of internship, or eighth year of training, is thus one of zero income but no cost. The previous 7 years were years of cost and years of zero income. The physician who wishes to specialize, in addition to his year of internship, must serve one or more years—depending, in part, on the field he has chosen—as a resident in an approved hospital. As a resident he will receive board and room and a nominal salary. At about age 28, then, our typical physician may begin to earn an income.

During the 7 years before graduation from medical school our physician spent about $3,500 for tuition, books and the like—exclusive of board, room and clothing. During his 2 years of internship and residency he was presumably self-sustaining on his small salary. But the money he might reasonably have earned throughout the entire 9 years of training, in addition to the value of the perquisites and small salary of his internship and residency, must be added to the $3,500 expenses incurred in school. This income would have been roughly $26,500 for the 9 years. Thus his out-of-pocket expense plus his lost income is approximately $30,000. When interest is accumulated on this amount the 9-year training period has cost the young man entering the practice of medicine at age 28 roughly $35,000.[1] He must amortize that investment—pay it off in annual installments—before it can be truly said that he is even with another man of the same age who started to earn after leaving high school at age 18.

An endowment policy for $35,000 in force from age 28 to age 65—the traditional age of retirement—and payable in full at age 65 or death, whichever is earlier, would require a premium of about $800 per year.[2] An additional $1,400 per year, the 4-percent interest on a $35,000 capital investment, must also be recovered. Thus a physician must earn $2,200 per year after paying the expenses of operat-

[1] This sum excludes, of course, the costs to the medical school (over and above tuition) for the 4 years of training, about $10,000.

[2] The self-employed physician does not face automatic retirement at age of 65 as do many company physicians and therefore may provide for his old age by continuing to work. But if he does continue to practice he is, of course, denied the leisure of the retired company physician, who can live on a pension prepaid during his working years.

ing his office and after paying taxes on his income just to amortize the cost of his training. The operating expenses (office rent, personnel, supplies) of a physician in private practice generaly run about two-fifths of his gross income. His income taxes, depending on his income bracket, may be any one of numerous possible amounts. Nevertheless, considering expenses and taxes, it is reasonable to estimate $5,000 per year as the minimum allowance in terms of gross income necessary to amortize a capital cost of $35,000. Hence the first $5,000 of gross income for the physician should be excluded in making comparisons with the earnings of a person whose earning period started at age 18.

The original investment cost, depending on the length of the training period, is not equally great for all professions. For example, the time spent in training by the certified public accountant is appreciably shorter than that of the physician. Four years of college and some additional work are generally necessary for certification. The accountant's working life expectancy, or the probable number of years between the beginning and end of his career, is greater than that of the physician. His lifetime earnings will accordingly be spread over a longer period of time and the degree of income tax discrimination against him less than the discrimination against the physician. The smaller amount of capital investment in accountancy training also imposes a smaller burden of annual amortization.

PHYSICIANS' INCOMES

How much does the typical physician earn? Available data indicate that at the outbreak of World War II the average annual income (after expenses) of physicians in active private practice was between $5,000 and $5,200. During the war the picture was greatly disturbed by the induction of 40 percent of the physicians into the Armed Forces. Sixty percent of the physicians, then, were left to care for the 90 percent of the population that remained at home. Studies of the Bureau of Medical Economic Research of the American Medical Association indicate that during the war period patient visits per physician increased three-fourths. Consequently the income of the civilian physicians rose sharply during the war, but not as fast as the national income. It is likely that the average net income in 1947 was about double the prewar level. More definitive statements can be made when the United States Department of Commerce returns to its prewar practice of conducting surveys of physicians' incomes.[4]

We do know, however, that the percentage of personal consumer expenditures made for the services of physicians is lower now than it was before World War II. National income and total personal consumer expenditures for all goods and services, when adjusted for the increase in population, have increased more rapidly than the income of the typical physician in the United States. (The number of physicians has increased 14 percent since 1940, whereas the United States population increased only 12 percent in the 8 years since 1940.) Moreover the amount spent for physicians' services as a percentage of the amount spent for all medical care items has been declining.

An examination of the Consumers' Price Index, developed by the United States Bureau of Labor Statistics, reveals that physicians' fees have not risen as rapidly as the entire index since the base period 1935–39. In 1947 the Consumers' Price Index stood at 159, as compared with 130 for the physicians' services part of the index. Thus, from the standpoint of prices or fees the physician has not enjoyed the general prosperity of the country. The physician has benefited from this prosperity in the fact that the percentage of uncollected fees has sharply decreased.

Of the roughly 200,000 physicians in the United States, about three-fourths, or 150,000, are in active private practice; the remaining 50,000 are retired or in full-time hospital service as interns, residents, or hospital superintendents or employed by Government agencies or business firms. Roughly 4,000 physicians are now (November 1948) employed by business firms, and roughly 19,000 are Government employees, many of whom share in retirement programs. Of the 150,000 physicians in active private practice more than 90 percent are individual proprietors. Approximately 2 percent are in group practice usually conducted as a partnership. Possibly 5 percent are in small partnerships, which we do not classify as group practice. Relatively few physicians in private practice are full-time salaried employees of nonprofit corporations. Some may derive more

[4] Plans have been completed for a survey of physicians' incomes to be conducted jointly by the U. S. Department of Commerce and the Bureau of Medical Economics Research in April 1950. The results of this survey will be published late in 1950.

than one-half of their income as part-time physicians for corporations. No data are available on the number of physicians now benefiting from corporation pensions and profit-sharing plans. In economic terms the overwhelming majority of physicians in active private practice in the United States can be best described as small retailers of professional services. It is reasonable to say that almost all the net income derived by physicians from private practice is fully subject to current Federal income taxes.

The physician's case, then, is this: He undergoes a long training period at a high cost. His earning period is substantially shortened because of this long training period. Since a considerable portion of his lifetime income is bunched into a relatively few peak earning years, he is placed in a higher income-tax bracket during those peak earning years and hence pays more income taxes during his lifetime than another person who receives the same lifetime income spread more evenly over a greater number of years. If he practices as an employee, he can receive some relief through section 165 (a) and related sections of the Internal Revenue Code by qualifying for an employee pension, which is not taxable until it is received. But since he typically practices as a single proprietor or partner, and not as an employee, he is subject to income-tax discrimination in this matter of pensions.

AMA ACTION

The board of trustees of the American Medical Association authorized its representatives (Mr. J. W. Holloway, Jr., director of the bureau of legal medicine, and me) to record, at a meeting of the Association of the Bar of the City of New York in February 1948, its support, in principle, of the proposal that the Internal Revenue Code be amended to permit physicians doing business as individual proprietors or partners to declare as business expenses the costs of pension programs for themselves with the proviso that there should be a reasonable maximum pension.[3] The American Medical Association believes that such an amendment would appreciably reduce the present discrimination.

The qualifying phrase "with the proviso that there should be a reasonable maximum pension" springs from a belief that without this limitation the proposal would lead to abuses and would sharply reduce Federal tax revenues. Regulations have been promulgated under section 165 (a) and related sections which set forth formulas designed to prevent abuses, that is, disproportionate benefits for high-salaried corporation executives, especially those who are large stockholders. Since employers are required to set up a plan which provides reasonable benefits for lower-paid employees, it is unlikely that pensions for higher-paid employees will be out of line. The infrequency of the employee-employer relationship in the practice of medicine might make a similar set of checks unworkable for the medical profession. For this reason the American Medical Association has recommended an over-all maximum pension.

In the hearings before the Committee on Ways and Means, House of Representatives, Seventy-seventh Congress, second session, on the revenue act (March and April 1942), Mr. Ralph E. Paul, then tax adviser to the Secretary of the Treasury, suggested $7,500 per year as one reasonable maximum for pensions financed by tax-free gross income. His suggestion was not adopted. If the decline in the purchasing power of the dollar is taken into account, his maximum today might be about $10,000. The American Medical Association has not recommended any specific amount as the maximum.

TWO METHODS

Two proposals for eliminating this tax discrimination against professional persons have been presented at this symposium by two eminent tax authorities, Mr. John R. Nicholson, of the Chicago Bar Association, and Mr. Harry Silverson, of the Association of the Bar of the City of New York.[4] Nicholson has suggested

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[3] This action of the board of trustees was reported in the Journal (136 : 834 [March 20] 1948).

[4] A complete description of the proposals of Mr. J. R. Nicholson (135 South La Salle Street, Chicago 3) and Mr. H. Silverson (1440 Broadway, New York 18) can be found in the following publications: Nicholson, J. R.: Pensions for Partners, American Bar Association Journal 33 : 302 (April) 1947; Comments on Mr. Rudick's Plan and Replies to His Strictures, American Bar Association Journal 33 : 1005 (October) 1947; Partnership Agreement Providing for Payment to Partner's Widow, Business Lawyer 2 : 20 (April) 1947; Tax Inequities Against Professional Men: A Remedy, Chicago Bar Association Symposium on Taxation of Earned Income (October 27) 1948 (mimeographed). Silverson, H.: A New Tax Proposal, American Mercury 44 : 345 (March) 1947; Earned Income and Ability to Pay, Tax Law Review 3 : 209 (February–March) 1948.

that the code be amended to permit individual proprietors and partners to qualify for the pensions financed by tax-free gross income. A different approach has been presented by Silverson. His premise is that taxation should be based on lifetime earnings or some kind of an average of lifetime earnings. Since it is impractical to devise a system of lifetime income taxes involving this concept, he believes that individuals should be enabled to postpone for some years, possibly to age 60, but at least for 5 years, the constructive receipt of some of their income. His plan involves exclusive investment of limited amounts of tax-free income in a special issue of low-interest-bearing Government bonds; taxes on the income invested in these bonds would be deferred until the bonds were cashed. The Silverson plan would appear to hold more appeal for some other professions than for physicians. Its greatest benefit would be received by those professional men whose incomes are severely affected by the business cycle, for example, architects. Both the Nicholson and Silverson plans deserve continued study. The extension of the Social Security Act to cover individual proprietors and partners has not been suggested in these meetings as a third proposal, for it obviously would not provide equitable treatment for those professional men with annual earnings in excess of $3,000, the present social-security limit.

It has been argued by some tax attorneys that it is not possible to eliminate the discrimination against the professions without making whatever relief is given available to all individual proprietors and partners—to farmers, storekeepers, and the like who do not incorporate. Be that as it may, I submit that the problem is greatest for professional persons—in particular, for physicians. It is imperative that a solution be found by those versed in the drafting of income-tax laws.

I do think, however, that in removing the present inequities we must be guided by one important consideration or limitation. We should not provide this tax relief in such a way as to increase the burden of the public debt for all of us. The specter of an increasing public debt is already before us. It is felt in the inflationary pressures in our economy. It may make the real benefits of a plan of deferred-income payments unrealized by the very persons whom the plan was designed to help, not only by decreasing the purchasing value of the pensions but also by making increased taxes necessary. The public debt in the form of Government bonds, although recognized as assets by the holders of the bonds (individuals and corporations) must be considered the liability of all our taxpayers. For the public debt consists of claims to be paid out of general revenues. These claims on the wealth of the country should be recognized as a debt by every person. If these claims were recognized as personal liabilities, citizens would realize that they are much poorer than they think they are when they forget about the public debt. Moreover, if each physician, lawyer, or other professional person would compute his share [7] of the burden of the public debt, he would be more anxious than ever to obtain immediate relief from the income-tax discrimination under discussion. With a rising public debt, there is no assurance that a tax rate for a given income bracket would not be increased at a later date to amortize the debt.

There will undoubtedly be much disagreement over the final details of a plan for eliminating the present tax discrimination against professional men. Nevertheless, professional persons, who must endure the cost of entering their profession late in life after prolonged and expensive training, must be encouraged to provide pensions for themselves. The need for amending our tax laws must be recognized and met if the goal of reasonable pensions for all is to be attained. The Social Security Act of 1935 marked the departure, at the Federal level, from the doctrine of individual responsibility for pensions. The 1942 Federal Revenue Act was a long step forward in rounding out this new idea. The task of rounding out that act to provide reasonable pensions for the self-employed in all income brackets must be completed before the new doctrine of social responsibility can be considered integrated and mature.

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[7] My method for computing an individual family's share of the public debt burden is presented in Bureau Bulletin 65, How Rich Are You? Chicago, American Medical Association, September 1948.

[Reprinted from the Current Comment of the Journal of the American Medical Association, April 29, 1950, vol. 142, p. 1366]

TAXES AND PENSIONS FOR PHYSICIANS

Under existing Federal tax laws, physicians who practice as individual proprietors or partners face certain tax inequities with respect to pensions. Elsewhere in this issue (p. 1357) Dickinson points out that section 165 (a) and related sections of the Federal Internal Revenue Code provide that a company can set aside funds under approved plans for employee pensions or shares in profit-sharing trusts which are deductible from the company's income as business expenses and, therefore, are not subject to income taxes. These funds do not become a taxable part of the recipient's income until they are received, either when the recipient retires or when he cashes in on his profit-sharing account—at which time he will presumably be in a lower income-tax bracket with a reduced tax burden. Only physicians and other professional men who are employees—for example, company physicians and company lawyers—can receive the benefits of such pensions. A physician undergoes a long training period (the longest among the professions), during which he foregoes income and incurs expenses accumulating to approximately $35,000 at the time of entering medical practice, at approximately age 28. The working lifetime remaining after this prolonged training period is shortened, and a considerable portion of his lifetime earnings is bunched into a relatively few peak earning years. During these peak earning years he is placed in a higher income-tax bracket, and hence pays more income taxes during his lifetime than another person who receives the same lifetime income spread more evenly over a greater number of years. Thus, the question of pensions for physicians acting as individual proprietors and partners is particularly perplexing for them because of the unusual economic pattern of their professional lives.

STATEMENT OF MAX L. WATERMAN, VICE PRESIDENT OF THE SINGER MANUFACTURING CO.

In connection with the pending tax-revision bill (H. R. 4473) the Treasury Department has proposed addition of household-type sewing machines to the list of electric, gas, and oil appliances that are taxable under section 3406 of the Internal Revenue Code. The Department advanced the same proposal before Ways and Means Committee, where it was rejected; section 484 of the bill does not include sewing machines.

While the proposal was not the subject of any specific comment in Secretary Snyder's appearance before this Committee on Finance in his February 8, 1951, statement before the Committee on Ways and Means, the Secretary supported the proposed extension of the tax on the ground that, in the interest of equity, some appliances not now taxed should be brought into the base of the tax. Also, he referred to the President's suggestion that additional revenue be raised from excise taxes on those consumer goods which are less essential or which use materials that will be in short supply.

So long as the excise tax is not imposed on the workman's tools or on the farmer's plow, it should not be extended to the housewife's sewing machine. For, as has been appropriately said, the sewing machine is a tool of home industry. Many women make their living by sewing on domestic or home-type sewing machines, and all use it as an important aid in reducing the cost of living.

The domestic sewing machine is an item of productive equipment—not a labor-saving device. Use of the sewing machine in the home will increase the housewife's burden, but will enable her to reduce the family's clothing costs by substituting her own labor for the cost of labor involved in manufactured clothing. A tax on sewing machines is indirectly a tax on clothing. When it is considered that no tax is proposed for industrial or factory-type sewing machines, it becomes clear that a tax on household sewing machines discriminates against clothing made in the home. This added burden placed on home clothing narrows the advantage to be gained by the enterprising housewife through her own efforts. This reduced incentive will produce results contrary to the announced desires of the Government. In the first place, large-scale home sewing means a reduced demand for the available supply of manufactured clothing which, in turn, eases the manpower demands of that industry. Scarcity of manpower is one of the serious problems in the present defense effort. Home sewing supplements the defense effort by adding spare-time hours of housewives to the labor pool supporting the production of clothing, a basic necessity. Over a hundred million new patterns are sold annually. More than 400,000 women take sewing lessons at the Singer shops alone each year. It may be conservatively stated that an equal number receive instruction at other points. These facts demonstrate that women are trying to clothe themselves and their families by their own effort, and avoid as much as possible the high prices of ready-made clothes.

The proposed tax cannot be justified on the theory that it will fall on an item which is not essential or which uses important amounts of materials that will be in short supply. From what has been said, it is clear that the sewing machine is the direct antithesis of the dispensable luxury. It is an absolute essential as we go into a period of belt tightening. The principal materials used in the manufacture of domestic sewing machines are ordinary cast iron, low-carbon steel, and noncritical hardwoods. The amount of aluminum used, when averaged over the different styles of domestic machines which we produce, amounts to approximately 1½ pounds of secondary aluminum per sewing machine. In the case of copper the only use is for a motor, and the average usage is only approximately one-half pound per sewing machine. The continued volume production of domestic sewing machines, with all the beneficial effects which flow therefrom, can therefore be supported by the consumption of relatively insignificant amounts of critical materials.

The returns from such a tax will be negligible, but the addition of the tax will have the effect of pricing the article in question out of the buying range of many consumers—those who may need it most.

Nor does any consideration of equity require that sewing machines be added to the base of the tax. A domestic sewing machine is not an electrical appliance. A sewing machine is a sewing machine. It is an article to perform sewing operations. The same sewing machine head may be operated by hand, by foot with a treadle, or by a motor. All three serve the same purpose. The use of an electric motor does not add one single function to the sewing machine. Electric power is merely another kind of power used to drive the machine. A true electrical appliance is useless without electricity or its usefulness is drastically impaired without an electrical motor. This is not true of sewing machines. The difference in time alone has made ordinary hand sewing well-nigh obsolete, particularly in the United States. The addition of a motor to a saw does not make it an electrical appliance.

The sewing machine is not a luxury. Its utility as an instrument of production gives it its appeal to those who, in times of emergency or rising prices, can afford only essentials. Thus, it is not competitive, directly or indirectly, with other items now subject to tax or proposed to be added to the tax base. The sewing machine serves a function of a different type, and its purchase arises from wholly different considerations.

In past national emergencies much of the burden of providing clothing for civilian needs has been thrown on the housewife using her domestic-type sewing machine. This was particularly true in World War II when a large part of manufacturers of clothing produced uniforms, etc., for the Armed Forces. In such times shortages of civilian clothing develop and unless an adequate number of household sewing machines are available at a price which the average citizen can afford, the depleted supply of available civilian clothing is rapidly exhausted with no means of replacement. Then, too, in times of emergencies domestic sewing machines are used extensively in repair work and in remaking existing articles of clothing. Home sewing should be encouraged, not discouraged.

The proposal to tax sewing machines was the subject of comprehensive testimony before the Committee on Ways and Means in March. The statements of the witnesses are set forth in part 8 of the printed hearings before the Committee on Ways and Means on Revenue Revision of 1951, as follows: Mrs. Mary Brooks Picken, president, Mary Brooks Picken School, page 2290; Mr. Glenn G. Nuss, president, White Sewing Machine Corp., page 2203; Mr. Raymond F. List, vice president, National Sewing Machine Co., page 2302; Mr. Lewis Emery, treasurer, Free Sewing Machine Co., page 2304; Mr. Max L. Waterman, vice president, the Singer Manufacturing Co., page 2306.

CONCLUSION

We respectfully submit that the home-type sewing machine should not be subjected to an excise tax. Such a tax would be a tax on clothing and this is contrary to the expressed policy of the Treasury and this committee. Home-type sewing machines are an essential item, and it is not in the national interest to discourage their use. They are in a separate category and not in competition with time-saving or convenience electrical household appliances.

JULY 24, 1951.

Senator EVERETT M. DIRKSEN,
United States Senate Office Building, Washington, D. C.

MY DEAR SENATOR: As the present head of a home-building organization, organized in 1887 by the writer's father, I find it very difficult to see any justice in a new tax proposal (which I understand has been passed by the House of Representatives), penalizing closely held corporations. Our organization, which now numbers among its executives my son (third generation), for 67 years has battled to build a worth-while business.

The bill in question provides, in the case of corporations wherein 95 percent of the voting stock is held by five or fewer persons, that such corporations shall be treated as one, getting the benefit of but one surtax exemption and one excess-profits-tax exemption. The difference in taxes is such as to make such taxes well-nigh confiscatory.

The victim of such legislation is the small-business man, since stock of most of such corporations is held similar to ours. Our shares are held by more than five people, but because of the provision respecting family ownership, legally would be considered to be fewer than five.

We believe you will agree that taxes should be fairly apportioned, and that in cases involving few shareholders in a corporation, such corporation should not be singled out for excessive taxation.

Surely, we should all pay heavy taxes in order adequately to assist in a strong defense program. We are, and of course should be, willing to bear our proper share, but the inequity of the situation in question tends to remove creative incentive, and a creative incentive we must retain. I believe you will agree.

Should the bill in question reach an appropriate Senate committee for hearings, I most sincerely hope that you will find it consistent to agree with my position. Further, I would appreciate an opportunity to appear before a committee during its investigation into the merits of the bill in question.

I would appreciate hearing from you and having your views. Thanks in advance.

Yours very truly,

MILLS & SONS,
By LAURANCE H. MILLS,
President.

BRIDGEPORT BRASS CO.,
Bridgeport, Conn., August 1, 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee,
The Senate, Washington, D. C.

DEAR SENATOR GEORGE: We appreciate an opportunity to present certain views to your committee on the application-of-growth provisions of the current excess profits tax.

Bridgeport Brass Co. is the largest independent company[1] in the brass-mill industry with manufacturing plants located at Bridgeport, Conn.; Indianapolis, Ind.; and Exeter, N. H. The company provides employment for some 5,000 employees with current payrolls running in excess of $10,000,000 annually.

GROWTH PRIOR TO 1946

Our company experienced growth problems of a type analogous to those recognized by your committee in its report on H. R. 9827 last December. It has grown steadily over the 85 years of its existence, particularly during the last 15 years when its sales and assets have increased more than five times. Unfortunately from a tax viewpoint, the company's major expansions took place in the two excess-profits-tax base periods, 1936–39 and 1946–49.

[1] It manufactures and sells a complete line of brass mill products in the form of sheet, rod, wire, and tubes, as well as fabricated products, such as plumbing goods, tire valves, and aerosol pressure-packaged products.

As a result of expansion in 1937 and 1938 when we built the first continuous rolling mill in the brass-mill industry at a cost of over $5,000,000, our earnings in the 1936-39 base period were materially reduced. The consequence was that during World War II the company paid out some $25,000,000 in taxes and renegotiation, which was more than our total assets at the end of the war.

This big pay-out left the company in a weakened condition at the end of the war to continue its growth and to meet the postwar inflation. When it acquired new plants in 1946, 1947, and 1948, it had to borrow some $13,000,000 to pay for these plants and to provide the additional working capital required to run them.

1947-49 NOT NORMAL YEARS

During the years 1946-49 the company was building up its organization to operate these new facilities, but it had to carry the load of the additional debt which it had incurred without obtaining the benefits of the potential earnings from the new plants. We have learned that people, rather than plants alone, make the most important contribution to our company's operations, and it takes us a long time (from 3 to 5 years) to develop a skilled organization to run a new brass mill profitably. Consequently, our expansion years 1946-49 do not truly represent the normal earnings to be expected from our investment in new mills during those years.

1946 AND 1950 APPROACHED NORMAL PROFIT LEVELS

In 1950 for the first time the company began to approach a normal profit from these new facilities in line with its experience over many years.

Your committee at its hearings in December made inquiry concerning our profits both before and after taxes for a period of years. In response to your inquiry, we attach exhibit 1. This is a comparison of our profits both before and after taxes with those experienced by all manufacturing concerns.

In the postdepression years of the 1930's our profits approached 7 percent before taxes. They were reduced by our expansion and the resultant dislocation and training of personnel in 1937-39. But the completion of the program enabled us to reach levels before taxes of some 9.9 percent during World War II.

However, a low average earnings credit from the base period 1936-39 reduced our profits after taxes to 2.3 percent of sales for the entire World War II period.

In 1946, the first postwar year, the company again achieved a normal earnings level of 9.6 percent before taxes.

However, a large part of the facilities included in the company's postwar modernization and expansion program were acquired toward the end of the 1946-49 base period. For that reason earnings realized during this base period did not reflect the return which our stockholders had a right to expect from these facilities.

In 1947 and 1948 our net profits after taxes were not sufficient to sustain service on our enlarged debt and to make provision for depreciation on our improved facilities and known future replacements, to say nothing of a fair return for our stockholders. Profits in 1947 were adversely affected by a sharp decline in customer demand created by a drastic reduction in customer inventories and further aggravated by uncertainties in the copper market. Also, in 1947 substantial quantities of surplus brass products were sold by governmental agencies at prices well below the existing market.

Profits in 1948 were unsatisfactory largely due to the fact that several new departments, including our newly acquired Indianapolis plant, had not reached their proper level of operating efficiency and potential earnings. During the year, substantial sums were expended in preparing the Indianapolis plant for producing thinner gages and smaller sizes of mill products needed by customers for regular commercial business. And, of course, the training of the organization of this plant to use this equipment was expensive and took several more years.

For the brass industry, 1949 was a recession year and our company suffered a severe loss.

So that, of the base period years, 1946-49, the only year which even approached normal rates of profit was 1946.

1950 NOT AN INFLATED YEAR

In 1950 we again reached a more normal profit return on commercial sales. We reached more efficient operation of our facilities contemplated by our training program, and our sales volume recovered from the low levels of 1949. We had only a nominal amount of Government business, and Government stockpiling of copper and zinc, which are our raw materials, limited even our commercial business.

We did not have the inflationary lift in 1950 experienced by many industries. For example, the average selling price per pound of all our brass mill shipments (including interdivisional) in 1950 was only 5.7 percent above the corresponding average for the year 1948. Copper and zinc hardly more than recovered their 1948 year-end levels (see exhibits 2 and 3), and our own 1950 margins remained substantially in line with those we experienced in 1948. So, by any standard, the 20-percent adjustment already made by Congress in the 1950 part of the growth formula would be more than adequate to cover a case like ours.

For all of these reasons 1950 was a fairer reflection of normal profits for our company with its expanded facilities than any of the years 1946–49.

PRESENT GROWTH FORMULA MISSES US

Your committee courteously considered our situation in its hearings on excess-profits tax proposals on December 6, 1950. At that time you indicated that our case was one which seemed worthy of relief, and a growth formula was devised to take care of many such growth situations. Unfortunately, the growth formula as enacted narrowly missed our qualifications.

1. Our assets were slightly more than the $20,000,000 total assets set forth in that formula.

Were $20,000,000 of assets to be continued as the dividing point, we respectfully suggest that this figure be used after an appropriate deduction for current liabilities. The resulting net figure would surely offer a fairer measure.

2. We did not reach the required increase of 80 percent in payroll or 50 percent in gross receipts during the last half of the base period. We could not because of the nature of our expansion and the low level of our operations during the loss year 1949.

We believe that the Congress will desire to develop a suitable alternative for growth companies which expanded in the base period years.

SUGGEST SLIGHT AMENDMENT TO GROWTH FORMULA

We, therefore, respectfully suggest that a growth formula equivalent to that provided in section 435 (e) be made available to companies whose total assets less current liabilities at the beginning of the base period were less than $20,000,000, whose growth during the base period was in line with that which we experienced, who suffered losses in 1949, and whose 1950 gross receipts were 150 percent of the average of those for 1946 and 1947. Further, such a formula could incorporate a choice of one-half of 1946, 1947, or 1948 profits before taxes to be added to 40 percent of those for 1950.

SMALL EFFECT ON TAX REVENUE

It is our belief that the enactment of this suggestion will not materially diminish the tax revenues of the Government, and we should be pleased to discuss this suggestion with the technical staff.

Recent events have emphasized the truth of the statements of Secretaries Marshall and Snyder to the effect that our present emergency will be prolonged for many years. Since production is our most potent weapon against the Communist world, we would avoid weakening our industry. Rather we should do everything possible to make it strong. This being so, it is particularly important that the interest in companies which grew during the base period expressed by your committee at its December hearings be enacted into the growth provisions of the excess profits tax.

This need of remaining strong has particular application to a company such as ours where remaining strong is the price of independence.

Respectfully submitted.

BRIDGEPORT BRASS CO.,
JOHN S. DAWSON,
Secretary and General Counsel.

EXHIBIT I

Comparison of Bridgeport Brass Co. and all manufacturing net profit before and after Federal taxes, percent of sales

	Bridgeport Brass		All manufacturing	
	Before Federal taxes	After Federal taxes	Before Federal taxes	After Federal taxes
Early thirties:				
1934	6.9	5.0	3.5	2.6
1935	6.2	5.4	4.8	3.7
Base period wartime excess profits tax:				
1936	7.8	6.3	6.4	5.2
1937	4.2	3.5	6.0	4.8
1938	[1] 1.0	[1] 1.0	2.2	2.3
1939	3.1	2.3	6.5	5.2
War period:				
1942	11.6	2.6	10.0	4.5
1943	11.1	2.5	10.1	4.1
1944	10.5	2.6	9.3	4.0
1945	4.5	1.5	7.7	3.1
Postwar period:				
1946	9.5	5.5	8.6	5.2
1947	4.5	3.0	9.8	5.9
1948	4.7	2.6	9.8	6.1
1949	[1] 4.8	[1] 2.2	8.0	5.0
1950	8.0	4.3		

[1] Indicates loss.

Source: Department of Commerce, National Conference Board Business Fact Book. Bridgeport Brass Co. figures are from published reports. Figures for "All manufacturing before Federal taxes" taken from National Income Supplement to the Survey of Current Business.

EXHIBIT 2

RANGE OF COPPER PRICES

(ELECTROLYTIC — DEL'D VALLEY)

1947 - 1950

CENTS PER LB.

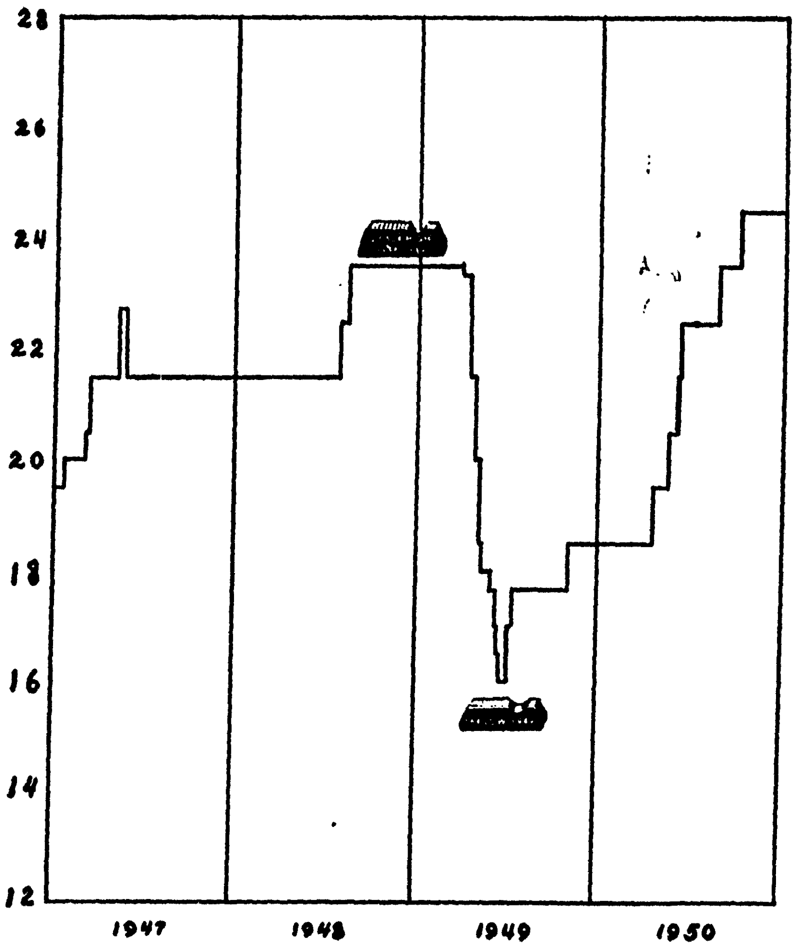
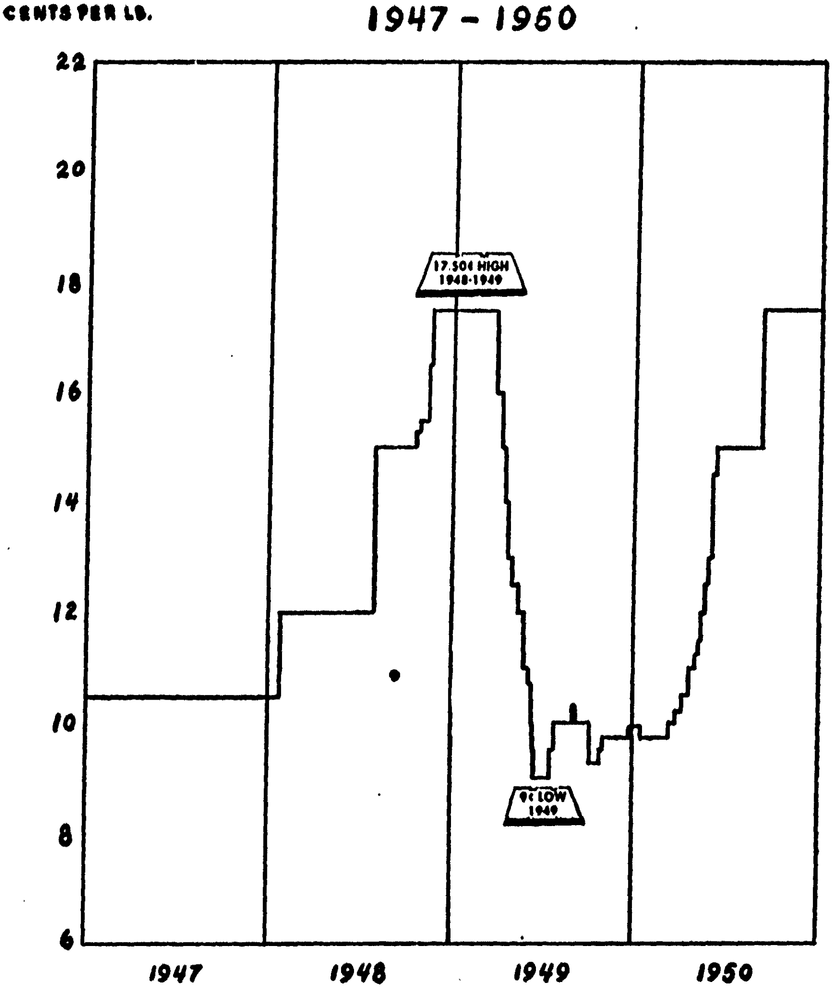


EXHIBIT 3

RANGE OF ZINC PRICES
(PRIME WESTERN – E. ST. LOUIS)
1947 – 1950



AMERICAN INSTITUTE OF ACCOUNTANTS,
New York 16, N. Y., August 2, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: The American Institute of Accountants, through its committee on Federal taxation, respectfully submits herewith recommendations for revision of the Internal Revenue Code. Our committee had sought an opportunity to appear before your committee for the purpose of making these suggestions but was requested by your committee last week to forego making a personal appearance and submit its recommendations in written form. The present submission, therefore, is made in accordance with your committee's request.

The American Institute of Accountants is the national organization of certified public accountants and has a membership in excess of 17,000. Most of our members are engaged daily in the application of the Internal Revenue Code in their accounting practice and we, therefore, represent a group which is well-qualified to make observations and suggestions on tax matters.

As a policy matter, our committee does not concern itself with tax rates or the tax structure. Accordingly, our comments will be limited to the technical features of H. R. 4473 and to the provisions of the Internal Revenue Code which have created gross inequities among taxpayers.

Our committee has for a number of months been giving serious consideration to a number of inequities in the Excess Profits Tax Act of 1950. Due to their great number, as well as their complex nature, our committee is not prepared, at this time, to make a detailed report on its proposed recommendations to correct these inequities. Additionally, a very important segment of the regulations, specifically, those dealing with part II, have not been promulgated by the Commissioner of Internal Revenue. Our committee has been in close contact with the Commissioner's office, has made numerous suggestions for incorporation in the regulations, and has a deep appreciation of the serious problems confronting the Commissioner in getting out regulations within a reasonable time. Nevertheless, these regulations have not yet been promulgated. In view of this most difficult situation, our committee desires to inform you that as soon as regulations are promulgated and finalized, we will submit detailed recommendations concerning excess-profits-tax matters.

As a result of the delay in the promulgation of regulations (which delay our committee fully appreciates could not be avoided), a very serious situation confronts corporate taxpayers. Under section 53 (a) (2) the Commissioner of Internal Revenue is empowered to grant extensions of time for filing returns for a period no longer than 6 months after the original due date. It is entirely likely that, at the very earliest, final regulations will not be out until shortly before September 15, which is the statutory limitation date for calendar-year returns (and even fiscal-year returns under the Excess Profits Tax Act). It will, therefore, be manifestly impossible for corporate taxpayers to digest and understand the regulations so that the numerous questions involved in filing proper returns by September 15, 1951, can be resolved. We, therefore, recommend that there be incorporated in H.R. 4473 an amendment granting an extension of time for filing returns for corporate taxpayers for a period of 90 days from September 15, 1951. We earnestly request your very serious attention to this grave matter.

In the alternative, if time does not permit incorporation in H. R. 4473 of a section which will adequately take care of this dire emergency, we suggest passage of a joint resolution of the House and Senate to grant appropriate relief to corporate taxpayers in this situation.

On April 4, 1950, our committee submitted to the Committee on Ways and Means 28 specific recommendations for amendment of the Internal Revenue Code. Three of these recommendations, Nos. 15, 18, and 23, have been adopted in principle by the Congress and enacted into law. There still remains a very pressing need for adoption of the remaining 25 recommendations and, while it is realized that revision matters will probably not receive consideration in the current bill, our committee feels impelled to renew with all earnestness its previous recommendations. A copy of the April 1950 recommendations is enclosed.

One of our April 1950 recommendations is included, in substance, in section 303 of H. R. 4473, which relates to nonrecognition of gain on the sale of a personal residence. We endorse that provision, but we wish to point out that the 1-year period for replacement may not be sufficient if the taxpayer desires to build a home under present conditions.

Another provision of H. R. 4473 merits comment, namely, section 201, relating to withholding of tax on dividends, interest, and royalties. This section places an impossible burden on the payor corporation if a dividend is paid in property. Not only is there a problem of converting some of the property into cash to pay the withholding tax, but, in addition, there is frequently a real problem of valuation of the property distributed as a dividend. The bill appears to place the liability on a corporation to withhold tax based on the correct valuation even though litigation may be necessary to determine the correct amount. Such property dividends should be exempt from withholding tax.

Section 131 of H. R. 4473 relating to fiscal-year taxpayers does not go far enough. Income of a partnership on a fiscal year basis should be prorated so that the individual partner pays tax thereon at the rates applicable to the calendar year in which such income is earned to be consonant with the treatment accorded to individuals under this proposed section. A partnership is not taxed as an entity, but each partner is taxed individually.

Our committee has followed with great interest the matter of granting tax relief to individuals to provide retirement income for themselves. A special subcommittee of our committee has made a detailed study of the Keogh and Reed bills (H. R. 4371 and H. R. 4373). As a result of this study, our committee desires to go on record approving the principles of these bills. There has long been need for a provision permitting a tax deduction for payments into a fund to provide retirement income for professional people since most lawyers, accountants, doctors, and other professional people are not covered by existing employer pension provisions. We recommend that the principle of the Reed and Keogh bills be incorporated into H. R. 4473.

In the light of the understanding with your committee at the time we were requested to forego making a personal appearance at your hearings on H. R. 4473, it is our desire that this letter shall become part of the official record of hearings on H. R. 4473.

Respectfully submitted.

THOMAS J. GREEN,
General Chairman, Committee on Federal Taxation.
WALLACE M. JENSEN,
Chairman, Subcommittee on Current Tax Legislation.

STATEMENT OF F. CLEVELAND HEDRICK, JR., WASHINGTON, D. C., ON BEHALF OF WDSU BROADCASTING CORP., NEW ORLEANS, LA.

WDSU Broadcasting Corp., the owner and operator of a radio and television station in New Orleans, La., appreciates this opportunity to bring to the attention of the committee an obvious error in section 445 (c) of the Internal Revenue Code which vitally affects the computation of the excess-profits credit of every corporation commencing business after December 31, 1949, and seeking to use the provisions of such section, which purports to permit the credit to be determined by applying the base period industry rate of return to the total assets of the company.

Under section 445 (c) the total assets for any of the first three taxable years are computed by taking the total assets on December 31, 1949, and adding the net capital addition for the taxable year involved. The total assets for determining excess-profits credit for any taxable year after its third taxable year is computed by taking the total assets on December 31, 1949, or the last day of its third taxable year, whichever day is later, and adding net capital additions.

Where the taxpayer commenced business on or after January 1, 1950, its total assets for its first 3 years are determined under section 445 (c), which means that its total assets is in effect the amount of the net capital addition for such years determined under section 435 (g) since it obviously has no assets on December 31, 1949. The effect of this is to give the taxpayer a much lower credit than would be obtained by applying the industry rate of return to total assets as of December 31, 1950. Only 75 percent of assets acquired by borrowed capital are used in calculating the capital addition, while 100 percent of the interest on borrowed capital is deducted. On the other hand, the total assets for its fourth and subsequent taxable years is measured by the total assets on the last day of the third taxable year, plus capital additions for the current year, and the total assets on the last day of the third taxable year are not affected by whether the money was borrowed or acquired through stock issue. Furthermore, if the corporation had commenced business prior to January 1, 1950, and had acquired assets before December 31, 1949, the computation of its total assets would commence with a determination of its total assets on December 31, 1949, unaffected by whether the assets were purchased with borrowed money or equity money.

The legislative history of the section indicates that no such discrimination against corporations commencing business after December 31, 1949, was intended.

The House bill contained the following language with reference to the matter of computing excess-profits credit of such a taxpayer for the first three excess-profits-tax years: "For the taxpayer's first taxable year, if such taxable year is in excess-profits-tax taxable year, by multiplying the amount of the taxpayer's total assets for the last day of such taxable year by the base period rate of return for the taxpayer's industry." Similar provisions were made for the second and third excess-profits-tax years.

The Senate Finance Committee made the changes which appear in the present provisions of section 445. However, the Senate Finance Committee report (Rept. No. 2679, 81st Cong., on H. R. 9827, at p. 26) states: "When the taxpayer's first, second, or third taxable year ends after the base period, the credit is determined for each of these years by applying the industry average base period rate of return to the taxpayer's total assets for each of such years. The credit for subsequent years is determined in a similar manner on the basis of total assets at the close of the taxpayer's third year or its last excess-profits tax year, whichever is later."

The conference committee report merely states with reference to the Senate amendment that "Amendment No. 134: This amendment strikes out certain provisions of section 444 of the House bill relating to the method of computing average base period net income for new corporations and inserts new rules for the computation."

A document entitled: "Summary of H. R. 9827—The Excess Profits Tax Act of 1950" as agreed to by the conferees prepared by the staff of the Joint Committee on Internal Revenue Taxation, December 1950, and distributed January 3, 1951, states at page 16 in explanation of the alternative basis for new corporations as follows: "When the taxpayer's first, second, or third taxable year ends after the base period, the credit is determined for each of these years by applying the industry average base period rate of return to the taxpayer's assets for each of such years. The credit for subsequent years is determined in a similar manner on the basis at the close of the taxpayer's third year. A new corporation receives an adjustment for capital additions in the tax period when made more than 3 years after it commenced business."

It seems clear that neither your committee nor the staff of the joint committee contemplated the result described above. We understand that the staff is aware of the problem and will at the appropriate time make a recommendation to correct the statute.

It is suggested that the intent of your committee as expressed in Report No. 2679 can best be carried out by restoring the House language, which will clearly permit corporations commencing business after December 31, 1949, to have the full benefits of the "total assets" method of computing excess-profits credit.

MILWAUKEE, WIS., *August 2, 1951.*

HON. WALTER S. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.:

Will you please have inserted at the appropriate time in the record of the present hearing the following statement of Harold E. Waltz, executive manager of the Photographers Association of America, Toledo, Ohio. This association representing professional and industrial photographers respectfully requests and urges the great importance of favorable action of your committee on section 485 of the tax bill as our testimony on previous hearings verifies the correction in the present photographic excise-tax law which will be made by the section. This has long been greatly needed to correct serious and special inequities and to stop taking our production equipment, materials, and livelihood tools.

HAROLD E. WALTZ,
Executive Manager, Photographers Association of America, Secor Hotel, Toledo, Ohio.

KANSAS STATE CHAMBER OF COMMERCE,
Topeka, Kans., July 31, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: As you know, thousands of people in Kansas and the Midwest have lost their homes and all of their property as a result of the floods which have ravaged this area in recent weeks. The spirit which these flood victims have demonstrated has been heart-warming and encouraging, but it cannot overcome the fact that they cannot absorb their losses unless they are aided in every way possible.

Accordingly, the Kansas State Chamber of Commerce appeals to you and to the members of the Senate Finance Committee to give immediate favorable consideration to including provisions in the Internal Revenue Code which will permit the offsetting in its entirety of any flood loss against current and future income subject to income tax, whether suffered by business or nonbusiness property, to the end that victims of these floods will receive tax benefit for every dollar of flood loss sustained, less amounts recovered by insurance or grant.

This relief measure was recommended July 26, 1951, by the Federal Taxation Council of the Kansas State Chamber of Commerce, which is composed of the leading authorities on Federal taxation in this State. It was unanimously adopted on July 27, 1951, by the board of directors of this organization, which represents every section of Kansas and every phase of the economy of the State.

We believe it would be a reasonable and fair procedure to permit owners of nonbusiness property to spread their loss over a period of time, as is currently the procedure open to owners of business property. We respectfully urge that the Senate Finance Committee take immediate action to incorporate such provisions in the new revenue act which is not under consideration by this committee.

Sincerely yours,

M. W. WATSON, *President.*

MEDICAL SOCIETY, STATE OF NORTH CAROLINA,
North Wilkesboro, N. C., August 1, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR MR. GEORGE: It has been brought to the attention of the North Carolina State medical headquarters that an amendment to the revenue code No. 18 has been proposed. This has to do I understand, with retirement benefits for self-employed and professional people. It is felt by the medical men with whom I have talked, many of whom find themselves in the high income brackets over a relatively short period of time during the height of their earning capacity which averages about 15 to 20 years, that this works a great hardship and is unfair discrimination.

The average doctor spends about 10 years and large sums of money in obtaining his education and preparing himself for the practice of medicine. The time spent during his training, in which there is no income, and expense involved has been figured at approximately $30,000. The average man, of course, begins at the same period with a lower income, pays less income tax and accumulates more over a longer period of time than the doctor for reasons set forth above.

For these reasons I personally feel, and I believe I express the feelings of the medical profession of North Carolina, that the medical profession should be included in the provisions of this bill.

The bill referred to above I understand is H. R. 4473 and is now being considered by the Senate Finance Committee of which you are chairman.

Cordially yours,

FRED C. HUBBARD,
President, North Carolina Medical Society.

CHICOPEE MANUFACTURING CORP.,
New Brunswick, N. J., July 31, 1951.

Hon. WALTER GEORGE,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: Chicopee now has 5 mills in Georgia employing over 1,500 people. The economic progress and financial stability of our employees is being materially affected because of the excess-profits tax in its present form.

The tax seriously affects the financial condition of our business. The resultant effect is to limit growth and expansion, which in turn has its limiting effect on job opportunities for our people. The growth of this company has always been financed out of profits; without reasonable profits, we face economic strangulation. Under the existing excess-profits tax, we have no possibility of relief. Amendments to the law would only create greater inequities. The application of a base period should be removed as unrealistic.

I, therefore, urge that the excess-profits tax be abolished and a flat tax on all corporate profits be substituted—a more sensible and sound approach.

Sincerely yours,

G. O. LIENHARD, *President.*

YOUNG AMERICAN BUSINESS CONFERENCE,
Houston 5, Tex., August 1, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Reference is made to my telegram of July 23. The Young American Business Conference, which now represents scores of small businesses throughout the country, believes the present excess-profits-tax law is highly discriminatory to those companies formed since 1946, and that a full exploration of the drastic effects of this law on small new businesses who will be America's industry of tomorrow should be undertaken immediately. We believe that the 10-minute token hearings now being held by the Senate are insufficient to bring out the facts or delve into the problem of justified relief.

The members of the Young American Business Conference do not believe that it is the intention of Congress to create a discriminatory tax or to work an undue hardship on small, new businesses. Although we are perfectly willing to pay our fair share of the tax burden, we absolutely cannot continue to maintain our present positions competitively, much less enjoy our normal growth and expansion, with the tax as it now stands and as it is proposed.

In his report of January 15, 1951, to the Senate, Senator Sparkman of the Small Business Committee, stated, as a result of his hearings along other lines:

"It (the Excess Profits Tax Act) of necessity will bear more heavily on the young and growing businesses which have no historical profit base with which to meet the burdens of emergency taxation. * * * Furthermore, it is these really small enterprises which often need all their profits to plow back into the business to meet their capital requirements. Many studies have shown this reinvestment of profit to be the chief source of capital for small businesses and, as the basic tax rate rises, the amount of profits remaining after taxation will be proportionately reduced. With taxes at increasingly high wartime rates, it becomes more evident that no entrepreneur, however wise, will be able to meet his capital needs in this manner."

Further, it is the already expressed policy of both your committee and the House Ways and Means Committee to avoid undue penalty to new businesses through this law. This desire is expressed in paragraph 10, page 25, of Report No. 2679 of the Senate Finance Committee. Unfortunately, the "industry average" form of relief thus proposed is far from adequate, as the experience of hundreds of small corporations has already demonstrated.

The present excess-profits tax law, hastily enacted last fall to meet an emergency, has created a condition which threatens the American system of free enterprise and competition; and the future American business leadership is being taxed out of existence because:

1. There are insufficient funds left after taxes to plow back into necessary plant expansion and improvement;
2. There are insufficient funds left after taxes for the increased working capital requirements in an expanding business;

3. The necessity of paying 50 percent of the tax by March 15 further decreases available working capital;

4. Small new businesses are forced to charge regular depreciation on plant and equipment and yet compete with older established companies who in many cases have already written off such equipment;

5. Small new businesses are forced to plow back every cent to fixed assets and increased inventories and therefore cannot accumulate any of the necessary reserves required to tide the business over a business cycle bobble;

6. Small new businesses less than 5 years old are still considered risky by bankers and insurance companies, and therefore it is virtually impossible to obtain capital loans from these sources;

7. Small new businesses which have developed new products and processes but which are held down by high taxes to the extent that they cannot expand fast enough to meet the demand they have created and enjoy the business which they have rightfully earned, are being made a prey to the larger corporations who have the necessary funds to take advantage of the market which the little fellow has developed;

8. Of all the small corporations formed since 1946, only a few, perhaps 1,000, are advanced enough in their profit picture to be severely hurt by the excess-profits tax law. Yet, under a less severe tax program these rapidly growing companies of today would be America's new industries of tomorrow. Through rapid growth they would actually furnish more revenue to the Government in 2 or 3 years. The loss of revenue to the Treasury this year and next year would be relatively small under our proposals (probably less than $50,000,000), yet we shall be encouraging competition, free enterprise, and American leadership and industry of tomorrow. This is certainly a small tax for the Treasury Department to defer.

9. None of the present methods of computing taxes takes into consideration that in most cases a manufacturer loses money during the first 12 to 18 months before he is able to break even and start making money.

10. The law as it presently stands, extending no growth company relief to new corporations, is ex post facto legislation against veterans. The majority of World War II veterans were still in uniform on January 1, 1946, and thus had no chance to get into postwar business in time to qualify for growth-company relief.

There was a time in American history when a man could invent a new product or discover a new way of doing something and, through diligent work, good leadership, efficient management, and aggressive selling he could build an industry. Under such conditions the automobile industry, the aircraft industry, the appliance industry, and the chemicals industries were built. Tomorrow's industries which will keep our country strong and employment at a high level cannot be built on a 62 or 70 percent tax today.

Please understand that small new businesses do not cry for tax relief to put money in their own pockets. We want this tax relief to put the money back into our businesses. Therefore, the Young American Business Conference proposes:

(1) That a modification of the growth-company formula be extended to those qualified firms who have been incorporated since 1946, even up through 1951; and

(2) That small new corporations of less than 5 years' corporate existence be allowed 20 percent of their income each year tax free, providing such income is used for plant expansion or improvements.

Under No. 1 above, Congress should realize that in spite of Korea there are bound to be some new businesses and industries formed as a result of technological advances and new ideas, which would prosper without a mobilization-stimulated market. We can't brand all new corporations as "war profiteers" simply because they were formed just prior to or during a limited war.

Under No. 2 above, a 20 percent income exemption for expansion purposes would place small new corporations on a 42 to 50 percent tax, which would allow them to grow on a somewhat similar tax basis to those companies formed from 1936 to 1946.

I think you will find that the above proposals are neither greedy nor unreasonable. But the present excess-profits-tax law is certainly discriminatory, unmerciful, and unjust.

For the above reasons it is only fair, prudent, and in the interest of the future of our country, as well as for future revenue to the Treasury Department, that the question of excess-profits tax as it affects small new businesses formed since 1946 should be investigated fully and quickly, either by a subcommittee of the Senate Finance Committee or by the Senate Small Business Committee. We sincerely believe that if the Treasury Department and Congress will only pause to consider for a brief moment, you will quickly realize that you can pluck more feathers from an adult rooster tomorrow than you can from a baby chick today.

Cordially,

J. S. FINGER, *Chairman.*

AMERICAN DENTAL ASSOCIATION,
Chicago, Ill., August 3, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington 25, D. C.

DEAR SENATOR GEORGE: This letter is in response to the telegram of Miss Elizabeth Springer, inviting the American Dental Association to submit for the record its views with regard to the amendment to H. R. 4473, a bill to provide revenue, proposed by Senator Ives of New York on July 25.

Briefly stated, the purpose of this amendment is to provide a method whereby bona fide members of professional organizations can, to a certain extent, level off their lifetime earnings by postponing a portion of the income tax which would otherwise be levied upon their earned net incomes in any 1 year, until the funds upon which such tax would otherwise be levied would become available for personal use upon the retirement of the professional person.

Under the proposal a professional man could pay not to exceed 10 percent, or $7,500, whichever is less into a retirement fund sponsored by his profession, during each of his earning years. This sum would not be subjected to income tax during the year in which it was paid into the fund, but would become taxable at the rates then current, when withdrawn after retirement by any of the methods proposed in the amendment.

In electing to serve his fellow man in the field of personal health services, the dentist, like the physician, the lawyer, and other professional personnel, deliberately postpones the beginning time of his earning period until many years beyond the time when high-school graduates first enter the employment market, and for a considerable time beyond the time when the 4-year-college graduate becomes employable. Today no person can become a dentist until at least 6 years after his graduation from high school and in most instances this time is postponed 7, 8 or more years, depending upon the number of years he spends in college prior to entrance to dental school and in an internship or residency subsequent to graduation but prior to commencing practice.

During this period of preparation for his life work the professional man is investing both actual cash for the cost of his education and subsistence and time when he might otherwise be accumulating funds in gainful employment. Subsequent to his entry into practice he passes through years of low income while attempting to establish a practice. After he is established he has a relatively few years of peak income, following which there is a rapid decline. In the case of dentists this income curve starts at about $3,000 annually at age 25, rises to slightly in excess of $9,000 in his early forties, and then diminishes until it reaches the $3,000 point of beginning after he passes his sixty-fifth year. His death, in accordance with the statistics for most white males, will occur shortly after age 65. During his earning period, he must recoup the funds he has invested in his education, meet his ordinary living expenses and still find a way to provide for his old age and that of his widow.

During his earning lifetime the member of a learned profession is dependent solely upon the difference between his gross and his net earnings for his sustenance. No special provisions favor him in providing for his old age. Unlike many of those employed by others, no one provides a pension fund for him and pays part of its cost. No friendly law guarantees him minimum income in the event his patients fail to patronize him, as is provided for the farmer whose market is depressed. No one pays him unemployment benefits in the event his business fails. By his own choice he is excluded from the benefits of old age and survivors' insurance.

His very independence makes him more susceptible to the inherent inequities in our tax laws. It gives him the chance to make a varying income but it subjects him to the loss of a larger part of that income to the tax collector, viewed from the aspect of his total lifetime earnings, than is the lot of his fellow citizen who chooses to work for another. In his years of low income he pays as much tax as his neighbor; in his years of high income, the surtax sequesters a large part of his temporarily high earnings.

The Ives' amendment offers a partial relief to the professionally self-employed. It does not absolve them of the total tax cost of years of abnormally high earnings, but it does serve to eliminate some of that burden and to postpone the remainder until that portion of the funds set aside under the provisions of the amendment actually become available as disposable personal income. The house of delegates of the American Dental Association considered this problem in 1948 and adopted a resolution endorsing the principle of some form of tax relief for the professionally self-employed. The council on legislation has examined the proposal of Senator Ives and believes that it comes under the terms of that resolution. It therefore endorses the proposal as made.

The cost of the proposal, so far as dentists are concerned, would not be unduly high. As is shown by the attached table, the revenue lost to the Government in any one year would be approximately $8,000,000 if every dentist availed himself of the benefits of the amendment to the maximum extent, a highly improbable occurrence.

The council on legislation, on behalf of the American Dental Association, respectfully requests the favorable recommendation of the committee with regard to the proposed legislation.

Respectfully yours,

Paul E. Jones, D.D.S.,
Member, Council on Legislation.

Mean net income of self-employed dentists, by age groups, as affected taxwise by the Ives amendment to H. R. 4473

Age group	Number of dentists	Net earned income	Present tax	Tax under amendment	Available for fund	Tax saving	Group cost tax loss
Under 25	825	$3,058	$270	$222	$306	$48	$39,600
25 to 29	10,050	4,868	553	476	487	77	773,850
30 to 34	10,425	7,480	762	660	748	102	1,063,350
35 to 39	9,525	9,032	1,042	880	903	162	1,543,050
40 to 44	8,325	9,308	1,090	924	931	166	1,381,950
45 to 49	7,950	8,623	968	812	862	156	1,240,200
50 to 54	8,325	8,307	910	762	831	148	1,232,100
55 to 59	6,825	7,144	942	814	714	128	873,600

Notes

Columns 2 and 3 derived from 1948 Survey of Dental Income by Department of Commerce.

Income-tax amounts calculated by Bureau of Economic Research and Statistics, American Dental Association. Groups "under 25, 25 to 29, and 55 to 59" assume 2 tax exemptions; all others assume 4 tax exemptions.

Data on incomes of dentists over 60 excluded since that age is fixed for retirement under Ives' amendment.

Total maximum cost to Government in any one year, assuming above data and 1950 tax rates, $8,147,490.

Gross tax savings to dentists on incomes ages 25 to 59, both inclusive, estimated at $4,743. Gross deposits in pension fund, possible $27,576 during same period. Annual withdrawals over 15-year period after retirement if maximum contributed $1,838.40 plus share of earnings of pension fund.

Pennies have been disregarded in all examples and sums rounded to nearest dollar.

Controlled Companies of
American District Telegraph Company,
New York, N. Y., August 1, 1951.

Hon. Walter F. George,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

My Dear Senator George: Further reference is hereby made to information received from Elizabeth B. Springer, the clerk of your committee, that although a requested appearance before your committee in opposition to the inclusion in the Senate version of the Revenue Act of 1951 of section 123 of H. R. 4473 could not be effected due to necessary time limitations, a written statement of our views could be submitted to you, as chairman of the committee, for inclusion in the record of your hearings.

We should like to avail ourselves of this courteous invitation and submit herewith a memorandum of our views on section 123, for inclusion in the record.

Thank you very much for this opportunity to present the facts which we believe clearly demonstrate the inequity of section 123 as presently proposed.

Very truly yours,

E. A. WARD, *President.*

MEMORANDUM IN OPPOSITION TO THE ENACTMENT OF SECTION 123 OF H. R. 4473 IN ITS PRESENT FORM BECAUSE SUCH ENACTMENT WOULD INTRODUCE SEVERE INEQUITIES INTO THE DETERMINATION OF THE FEDERAL INCOME TAX LIABILITY OF CORPORATE BUSINESS ENTERPRISE IN GENERAL AND THE CONTROLLED COMPANIES OF THE AMERICAN DISTRICT TELEGRAPH CO. (NEW JERSEY) IN PARTICULAR

THE PROPOSAL AND ITS PURPOSE

Section 123 of H. R. 4473, as passed by the House of Representatives, would reduce to one the number of surtax tax exemptions which may be claimed by a group of "related" corporations and also confine such group to a single $25,000 minimum excess profits tax credit. The avowed purpose behind this proposal is to avoid loss to the revenues in a period of high corporate income and excess profits taxation through "the deliberate splitting up of corporations for the purpose of realizing the unusual tax advantages which present law permits" (H. Rept. No. 586, 82d Cong., 1st sess., p. 24).

LEGAL UNSOUNDNESS OF THE PROPOSAL

The revenues are now and long have been adequately safeguarded against the atomization of business into multiple units for tax-minimization purposes alone. Specific safeguards, among others, are contained in section 112 (k) and section 129 of the Internal Revenue Code, as well as the broad "in good faith for the purposes of the business" test which runs throughout the Excess Profits Tax Act of 1950. More general in scope, but no less effective, are the provisions of section 45. In addition, far-reaching judicial safeguards have been enunciated by the courts in such cases as *Gregory* v. *Helvering* (293 U. S. 465), *National Carbide Corp.* v. *Commissioner* (336 U. S. 422), *Fairfield Steamship Corp.* v. *Commissioner* (157 F. 2d 321), and *Commissioner* v. *Transport Trading & Terminal Corp.* (176 F. 2d 570, cert. denied, 338 U. S. 955), among a host of others.

The real purpose of the Treasury would thus appear to be not so much to protect the revenues against corporate split-ups motivated by tax considerations as to place a formidable tax obstacle to the operation of business enterprise through locally incorporated companies created in accordance with sound, independent business purposes. See for example such recent cases as *Alcorn Wholesale Co.* (16 T. C. ——, No. 10), *Berland's Inc. of South Bend* (16 T. C. 182), and *Chelsea Products, Inc.* (16 T. C. ——, No. 102).

The Treasury's present bitter opposition to subsidiary corporations is to be contrasted with the following very sane statement made by Mr. Justice Robert H. Jackson, then assistant general counsel of the Treasury Department, in testimony before this committee then considering the Revenue Act of 1936:

"We see examples of legitimate and almost necessary uses of subsidiary corporations by those whose operations are widely spread geographically. A nationally owned business may find it almost necessary, and certainly expedient to have subsidiaries in different States, often to comply with the requirements of the several jurisdictions as to qualifications for holding property or franchises. The Treasury would not favor a tax which would bear oppressively upon such legitimate operations."

The enactment of section 123, as presently conceived, into law would have the very effect which the Treasury wisely, in 1936, wholeheartedly wished to avoid.

PERTINENT HISTORY OF THE AMERICAN DISTRICT TELEGRAPH SYSTEM'S DEVELOPMENT

Starting from the most modest of beginnings about the turn of the century, the A. D. T. system through its fire and burglar alarm services today protects tangible property values exceeding $27,000,000,000. Central stations are maintained in all the principal cities in the United States to serve the subscriber to the electric protective services furnished by the A. D. T. system. Among these subscribers may be numbered the United States Treasury, 28 Federal Reserve bank buildings, the United States mints, and the Fort Knox and West Point bullion depositaries.

Today the controlled companies of American District Telegraph Co. comprise a group of 48 companies, the capital stock of each of which is owned virtually in entirety by American District Telegraph Co. (New Jersey), each operating in the State of its incorporation to supply electric protection service which safeguard lives and properties from the hazards of fire, intrusion, and sabotage. See attached pamphlet entitled "Protecting Life and Property" for brief description of services provided and scope of territorial coverage.

Set forth below are the incorporation dates of the various corporate entities comprising the A. D. T. system together with the dates upon which the parent company acquired its stock interest.

Controlled companies of American District Telegraph Co. (New Jersey)

Name	State of incorporation	Date of incorporation	Date of acquisition
The American District Telegraph Co	Alabama	Apr. 9, 1901	1902
Do	California	Sept. 10, 1887	1902
American District Telegraph Co. of San Francisco	do	Oct. 3, 1899	1902
The American District Telegraph Co	Colorado	June 12, 1883	1928
Do	Connecticut	Apr. 5, 1887	1902
Do	Florida	Dec. 19, 1898	1902
Do	Georgia	May 26, 1909	1909
Do	Illinois	Mar. 3, 1899	1902
American District Telegraph Co., Inc	Indiana	Feb. 7, 1898	1902
American District Telegraph Co. of Iowa	Iowa	Mar. 1, 1899	1902
American District Telegraph Co	Kansas	Dec. 17, 1885	1902
Do	Kentucky	Nov. 16, 1899	1902
Do	Louisiana	Feb. 7, 1912	1912
Do	Maine	Aug. 26, 1902	1902
The American District Telegraph Co. of Baltimore city	Maryland	Aug. 18, 1874	1902
American District Telegraph Co	Massachusetts	Jan. 2, 1883	1902
Bankers' Electric Protective Association	do	June 11, 1907	1930
American District Telegraph Co	do	June 23, 1903	1908
Reliance Alarm Co	do	Nov. 4, 1946	1946
American District Telegraph Co	Minnesota	Mar. 14, 1884	1906
The American District Telegraph Co. of Minnesota	do	June 7, 1890	1902
American District Telegraph Co	Missouri	Mar. 5, 1901	1902
Do	Nebraska	May 1, 1887	1902
Do	New Jersey	Mar. 3, 1902	1902
American District Telegraph Co., Inc	New York	July 5, 1902	1902
Bankers' Electric Protective Association, Inc	do	Apr. 12, 1924	1930
American District Telegraph Co	North Carolina	Mar. 6, 1939	1939
American District Telegraph Co. of Cincinnati, Ohio	Ohio	Nov. 15, 1892	1902
The American District Telegraph Co. of Cleveland	do	Sept. 1, 1899	1902
The American District Telegraph Co. of Columbus	do	Nov. 1, 1876	1902
The American District Telegraph Co. of Ohio County	do	Dec. 20, 1898	1902
The American District Telegraph Co	do	Mar. 30, 1898	1906
American District Telegraph Co. of Toledo, Ohio	do	Jan. 11, 1901	1902
The American District Telegraph Co. of Oklahoma	Oklahoma	Sept. 8, 1899	1902
American District Telegraph Co	Oregon	Aug. 29, 1903	1903
The American District Telegraph Co. of Pennsylvania	Pennsylvania	Mar. 27, 1899	1902
American District Telegraph Co	South Carolina	June 13, 1903	1903
American District Telegraph Co. of Dakota	South Dakota	Nov. 8, 1919	1919
American District Telegraph Co., Memphis	Tennessee	Jan. 28, 1892	1910
American District Telegraph Co., Tennessee	do	Aug. 19, 1902	1902
American District Telegraph Co. of Texas	Texas	Oct. 9, 1900	1902
American District Telegraph Corp	Virginia	Apr. 2, 1908	1908
American District Telegraph Co	Utah	Dec. 28, 1897	1902
Seattle American District Telegraph Co	Washington	July 28, 1887	1931
American District Telegraph Co. of Washington	do	July 30, 1900	1902
American District Telegraph Co	West Virginia	May 12, 1903	1903
American District Telegraph Co. of Milwaukee	Wisconsin	Feb. 9, 1888	1902
American District Telegraph Co. of Wisconsin	do	Oct. 9, 1899	1902

From the foregoing it is seen that of the 48 corporations which comprise the A. D. T.-controlled companies, 41 have been owned by the parent corporation since before the ratification of the sixteenth amendment. In addition, it may be noted that the stock of the remaining seven companies was acquired in 1919, 1928, 1930, 1931, 1939, and 1946. The absurdity of supposing that the A. D. T. system's method of doing business has in any way been dictated by a desire to escape its just burden of Federal taxation when all but 4 of the 48 companies have been in existence since before March 1, 1913, is thus amply demonstrated.

The creation and maintenance of the individual corporate entities was and is virtually inescapable for many reasons, among which are (1) a normal desire for limitation of liability, (2) the preservation of certain franchise and other rights embraced in the original charter heritage, (3) the greater facility with which negotiations for franchise and other permissions can be conducted at State and municipal levels, and (4) simplification of accounting apportionments affecting revenues, expenses, plant investment, etc. The operations of each A. D. T. company are essentially intrastate in character, and there appears to be every reason to so regard and maintain them, for all purposes. The individual companies operate autonomously. The Treasury's 1936 views as to the virtual business necessity of corporate subsidiaries as voiced by its then assistant general counsel, Robert H. Jackson, in language quoted above, is fully and peculiarly applicable to the business realities faced by the A. D. T. system.

FINANCIAL EFFECT OF SECTION 123 UPON THE OPERATION OF THE A. D. T. COMPANIES

Set forth below in schedular form is a chart showing the fiscal import, at once both severe and capricious, of the proposed changes in the law to be affected by section 123 upon the individual units of the A. D. T. system and upon the system as a whole. Based on 1950 taxable net income, the additional tax liability amounts to $181,314. As will be observed, the added tax liability ranges from a low of 1.6 percent to a high of 97.4 percent of the liability that would result without the application of section 123. This statement brings into sharp relief the effect upon low earnings companies. The depressive effect of the additional Federal tax upon the growth of such low-earnings companies must be obvious, and surely runs counter to the long expressed intent of the Congress to lend encouragement to such enterprises.

Showing effect of changes proposed in H. R. 4473, sec. 123, on the tax liability of the controlled companies of American District Telegraph Co. (New Jersey)

Name	1950 taxable net income	Normal, surtax, and excess profits tax at proposed 1951 rates but at 1950 exemptions	Normal, surtax, and excess profits tax at 1951 rates and exemptions	Indicated additional tax liability	Percent increase
The American District Telegraph Co. of Ohio	$1,484.56	$445.37	$771.97	$326.60	73.3
Bankers Electric Protective Association Inc. (New York)	1,521.60	456.48	791.23	334.75	73.3
Bankers Electric Protective Association, Inc. (Massachusetts)	7,897.65	2,369.30	4,106.78	1,737.48	73.3
American District Telegraph Co. (Utah)	11,310.46	3,393.14	5,881.44	2,488.30	73.3
The American District Telegraph Co. of Minnesota	13,799.66	4,139.90	7,175.83	3,035.93	73.3
The American District Telegraph Co. (Dayton, Ohio)	20,721.63	6,216.49	11,854.80	5,638.31	90.7
American District Telegraph Co. of Washington	22,851.99	6,855.60	13,378.98	6,523.38	95.2
The American District Telegraph Co. of Oklahoma	24,767.95	7,430.39	14,670.97	7,240.58	97.4
The American District Telegraph Co. (Nebraska)	26,211.99	8,774.20	14,274.20	5,500.00	62.7
American District Telegraph Co. of Toledo, Ohio	27,646.94	10,526.78	16,026.78	5,500.00	52.3
The American District Telegraph Co. (Colorado)	29,062.40	10,831.17	19,235.52	8,404.35	77.6
The American District Telegraph Co. of Columbus, Ohio	29,174.28	10,767.79	16,267.79	5,500.00	51.1
American District Telegraph Co. Inc. (Indiana)	33,282.21	14,291.41	22,415.73	8,124.32	56.9
American District Telegraph Co (Oregon)	36,674.07	14,535.57	20,035.57	5,500.00	37.8
American District Telegraph Co. (Louisiana)	42,325.56	21,706.96	28,374.31	6,667.35	30.7
American District Telegraph Co. of Cincinnati, Ohio	43,527.39	25,911.04	35,703.51	9,792.47	37.8
American District Telegraph Co. (West Virginia)	50,929.21	23,089.95	28,589.95	5,500.00	23.8
Seattle American District Telegraph Co. (Washington)	54,729.24	24,887.92	30,387.92	5,500.00	22.1
American District Telegraph Co. of Milwaukee	57,828.83	26,013.88	31,513.38	5,500.00	21.1
American District Telegraph Co. of San Francisco	67,090.76	29,387.20	34,887.20	5,500.00	18.7
American District Telegraph Co. (Connecticut)	72,119.80	40,634.67	46,134.67	5,500.00	13.5
American District Telegraph Co. (Massachusetts)	84,981.57	38,690.42	44,190.42	5,500.00	14.2
American District Telegraph Co. of Texas	86,084.18	46,983.42	52,483.42	5,500.00	11.7
American District Telegraph Co. (Minneapolis)	86,174.45	47,746.47	53,246.47	5,500.00	11.5

Showing effect of changes proposed in H. R. 4473, sec. 123, on the tax liability of the controlled companies of American District Telegraph Co. (New Jersey)—Continued

Name	1950 taxable net income	Normal, surtax, and excess profits tax at proposed 1951 rates but at 1950 exemptions	Normal, surtax, and excess profits tax at 1951 rates and exemptions	Indicated additional tax liability	Percent increase
American District Telegraph Co. (Michigan)	$88,157.78	$40,342.04	$45,842.04	$5,500.00	13.6
A. D. T. Co. (Kentucky)	88,442.94	52,362.47	57,862.47	5,500.00	10.5
The American District Telegraph Co. of Pennsylvania	91,777.04	42,224.06	47,724.06	5,500.00	13.0
A. D. T. Co. (New Jersey)	118,005.49	76,179.09	81,679.09	5,500.00	7.2
A. D. T. Co., Inc. (New York)	140,585.48	67,604.45	73,104.45	5,500.00	8.1
The American District Telegraph Co. of Baltimore City	168,134.76	100,991.77	106,491.77	5,500.00	5.5
The American District Telegraph Co. of Cleveland, Ohio	206,517.85	121,605.61	127,105.61	5,500.00	4.5
American District Telegraph Co. (Los Angeles)	227,121.25	140,240.84	145,740.84	5,500.00	3.9
American District Telegraph Co. (Missouri)	334,741.82	206,869.92	212,369.92	5,500.00	2.7
American District Telegraph Co. (Illinois)	593,167.92	339,905.65	345,405.65	5,500.00	1.6
The American District Telegraph Co. (Alabama)	(1)				
American District Telegraph Co. (Florida)	(1)				
American District Telegraph Co. (Georgia)	(1)				
American District Telegraph Co. of Iowa	(1)				
American District Telegraph Co. (Kansas)	(1)				
American District Telegraph Co. (Maine)	(1)				
Reliance Alarm Co. (Michigan)	(1)				
A. D. T. Co. (North Carolina)	(1)				
American District Telegraph Co. (South Carolina)	(1)				
American District Telegraph Co. of Dakota	(1)				
A. D. T. Co. (Memphis, Tenn.)	(1)				
A. D. T. Co. (Tennessee)	(1)				
A. D. T. Corp. (Virginia)	(1)				
American District Telegraph Co. of Wisconsin	(1)				
	2,988,850.71	1,614,410.92	1,795,724.74	181,313.82	11.2
American District Telegraph Co. (New Jersey) (parent company)	1,634,027.55	844,194.33	844,194.33		

[1] No taxable income.

SPECIFIC INEQUITABLE RESULTS OF THE APPLICATION OF SECTION 123, IN ITS PRESENT FORM, ON THE TAX LIABILITY OF ADT COMPANIES

1. We know of no other group of corporations on which the provisions of section 123 of H. R. 4473 will weigh so heavily. That many will be affected we have no doubt, but with respect of few other groups of corporations are you likely to encounter a situation where, as here, the aggregate disallowance of the $25,000-surtax exemption is equal to 28 percent of aggregate taxable net income.

2. In its over-all effect, the Revenue Act of 1951, as passed by the House, proposes an increase from 47 to 52 percent, or 5 percent in the normal and surtax rates applicable to corporations. By reason of the disallowance of the $25,000 surtax exemption, the aggregate tax liability of the ADT controlled companies is increased not 5 percent but 10.6 percent.

3. The retention of the $25,000 surtax exemption in the 1950 Revenue Act was specifically for the purpose of lending encouragement to the growth of small enterprises. It is not clear that a small corporation needs any less encouragement simply because its capital stock happens to be owned by another corporation. Regardless of its ownership, the small enterprise cannot flourish unless it be permitted, within the provisions of the Federal-tax structure, to retain the funds necessary to sound growth. Nor is it clear that the Ways and Means Committee, in drafting section 123 of H. R. 4473, intended to espouse the philosophy that the earnings of a corporation organized under the law of one State in which it does business, should be employed to support the low or deficit earnings of a corporation, similarly situated, doing business in another State.

It would seem, basically, that the Congress already has defined a small-business enterprise as one whose net taxable income does not exceed $25,000. Such being the case, and where there is no evidence of incorporation with intent to take undue advantage of tax exemptions, it is inequitable to allow the $25,000 surtax exemption and minimum excess-profits-tax credit to one specific group of small-business enterprises and not to another.

4. The Internal Revenue Code already imposes one penalty upon the employment of corporate subsidiaries by taking 15 percent of all dividend income. During 1950, ADT controlled companies paid dividends of $1,479,575 to the parent corporation, the tax on which at 52 percent of 15 percent would amount to $115,407. It is respectfully suggested that if the corporate entity is to be disregarded for the purpose of application of the surtax exemption and minimum-excess-profits-tax credit, it should be disregarded for all other purposes, and either that intercompany-dividend payments should be treated as wholly tax-exempt or the 2-percent premium eliminated which presently is assessed for the privilege of filing a consolidated income-tax return.

5. The proposed additional tax of $181,314, which would be assessed against ADT companies by reason of the enactment of section 123 of H. R. 4473, in its present form, appears doubly inequitable in light of the fact that subscribers to ADT protection services already are subject to a considerable tax burden imposed under section 3465 (a) (2) (B) of the Internal Revenue Code upon charges for wire and equipment service. During the year 1950, pursuant to this section of the code, ADT companies paid into the United States Treasury the sum of $1,910,020. Truly, the many ADT companies which fall into the small-business class of corporations have long borne up, cheerfully, under a crushing Federal tax load, and should not be asked to bear the additional burden threatened under section 123 of H. R. 4473.

6. The electric protection service industry, for several years, has been in a state of expansion, spurred by an ever increasing necessity to protect lives and property in a dynamic industrialized economy. This situation has called for the reinvestment of all available funds. The corporations have no surplus cash resources. It appears a foregone conclusion that the imposition of an additional tax liability totaling $181,314 will require the companies to seek relief from the ceiling price provisions imposed by the Office of Price Stabilization. Such action of necessity can but swell the forces of inflation and serve as a deterrent to the further use of electric protection services in the protection of industrial plants, stores of strategic materials and in the conservation of manpower, all so badly needed in furtherance of the country's defense effort.

7. From the standpoint of competition, the proposal contained in section 123 of H. R. 4473 seems calculated to work grave inequities. A. D. T. companies are faced with severe competition within every city of operation at the hands of many individuals and corporations relatively few of whom comprise members of a controlled group. The effect of section 123 of H. R. 4473, therefore, will be to place each A. D. T. company at a competitive disadvantage in the minimum sum of $5,500 annually. Dependent upon the excess-profits tax situation, the annual competitive disadvantage could amount to considerably more than this figure. It is not believed that it is the desire of Congress to act, thus, to weight the scale of the competitive economy.

8. For almost 50 years the ownership of the companies has been constituted substantially as at present. By the enactment of section 123 of H. R. 4473 Congress will so have rewritten the rules for doing business as to assess an inequitable tax burden upon the A. D. T. group of companies that long have striven, under competitive strain, to hold their place at even odds in the domestic economy.

SUGGESTED MODIFICATION OF SECTION 123

There are two ways in which the objective of section 123 of H. R. 4473 could be attained, while at the same time avoiding the creation of the foregoing inequities which would discriminate so unfairly against companies possessing a corporate structure and tax situation similar to that of the A. D. T. controlled companies. These are by the insertion of one or the other of the following provisions as section 123 (d) of H. R. 4473:

1. "(a) The provisions of this section shall not apply to any corporation which became a member of a 'controlled group' prior to January 1, 1940, or

"(b) The provisions of this section shall not apply to any corporation which became a member of a 'controlled group' prior to March 1, 1913."

2. "The provisions of this section shall not apply in the case of any corporation a member of a 'controlled group' furnishing wire and equipment services, charges for whose services are subject to taxation under section 3465 (a) (2) (B) of the Internal Revenue Code."

Favorable consideration of the foregoing representations is earnestly and respectfully sought.

STATEMENT ON BEHALF OF PABCO PRODUCTS, INC.

My name is Randolph E. Paul, attorney of Washington, D. C. I am submitting this statement on behalf of Pabco Products, Inc., 475 Brannan Street, San Francisco, Calif., in order to bring to the attention of this committee several serious inequities in the excess-profits-tax law.

As the committee is well aware, Congress imposed the excess-profits tax in 1950 in order to siphon off increased corporate profits attributable to the Korean hostilities and the large military expenditures of our defense effort. Needless to say, the tax was not designed to reach the normal earnings of a corporation. However, in actual operation, as specifically illustrated by Pabco Products, the existing law provides an inadequate credit for the normal earnings of a company which began the construction of increased productive capacity more than 2 years before its first excess profits taxable year and completed such construction after the end of its base period.

The excess profits credit based on income is predicated upon the allowance of an amount which is a fair and just reflection of the normal earning capacity of a business. Congress provided various relief provisions to assure that only excessive profits would be taxed. It had no desire to penalize a corporation which earns no abnormal profits. However, in the hurried drafting of the law, relief from the situation under which Pabco Products is unable to retain its normal earnings was overlooked in the letter of the law although it comes within its spirit. Unless the company can obtain adequate relief from the onerous hardships of existing law, it faces serious financial consequences because it expanded its peacetime productive capacity while less progressive competitors maintained their status quo.

FINANCIAL HARDSHIP UNDER THE EXCESS-PROFITS-TAX LAW

Pabco Products manufactures roofing, floor coverings, paints, and other building materials. It has a large plant in Emeryville, Calif., and smaller plants in other communities in California. Although the company has a reconstructed calendar year base period, it reports its income on the basis of a fiscal year ending June 30.

On February 9, 1948, Pabco Products borrowed $12,500,000 from two life-insurance companies to finance the construction of a linoleum- and felt-base floor covering plant at Raritan, N. J. The loan is repayable in annual installments of $300,000 in each of the years 1949 through 1951 and $750,000 in each of the years 1952 through 1962, with the balance payable in 1963. The proceeds of the loan were temporarily invested in United States Treasury bonds, which were periodically redeemed as funds were required for the payment of construction costs. The felt-base floor covering unit was completed and began operations in May 1950, more than 2 years after construction was commenced. The linoleum unit was completed and began operations in January 1951, almost 3 years after the start of construction.

The additional plant constructed by the company represents more than 190 percent of its entire net investment in capital assets at the time construction was begun. The decision in late 1947 to build the new plant was based on projected normal profits of $1,200,000 per year from its operation, taking into account the then current tax rate of 38 percent. Under the existing law, however, the income attributable to the additional $12,500,000 invested in this plant productive capacity, the additional facilities seemingly must have been in active is excluded from the company's normal earnings credit. The taxation of the entire income from the new plant as excessive profits reduces the projected net profits from its operation to about $400,000. Manifestly, Pabco Products will not be able to meet the annual repayments of $750,000 under the loan agreement out of the profits of this plant. Already the company has been forced to reduce the income of its stockholders from a quarterly dividend of 30 cents per share to a quarterly dividend of 15 cents per share. Not only are the stockholders deprived of any portion of the normal earnings of the new plant in the form of dividends, but they will continue to be penalized in order to assure working capital and annual loan repayments in excess of the potential plant earnings.

INADEQUACY OF EXISTING RELIEF PROVISIONS

Section 444 of the excess-profits-tax law is designed to provide some relief for companies which have increased their capacity for production or operation. However, the section is so narrowly drawn that its application fails to relieve gross inequities in many situations. To qualify for relief based on increased production by the end of the base period. Hence under the stringent requirements of section 444, companies such as Pabco Products are denied relief, although they began to increase production facilities long before the Korean War and the expanded military expenditures. They are denied relief merely because they were unable to complete their new plants before the end of the base period due to the extensive nature of their expansion.

Section 444, as it now stands, overlooks the basic consideration that an excess-profits tax does not properly apply to those earnings which reflect a corporation's normal earning capacity. In the case of old facilities those earnings are usually represented by actual earnings during the normal years of the base period. At the very least, new facilities which are unrelated to the abnormalities of the defense economy should be allowed the same rate of earnings as was normal for such facilities on an industry-wide basis. Even the much-criticized relief provisions of the former excess-profits-tax law wisely afforded relief in such situations. And under section 445 a new corporation formed to construct and operate the new plant constructed by Pabco Products would be entitled to a normal earnings return on the plant before its profits would be subject to the excess-profits tax.

Apparently the credit for capital additions during the latter part of the base period, contained in section 435 (f), was intended to complement section 444 and provide a measure of relief to a company investing in productive facilities which were not completed by the end of the base period. This section, however, falls short of the policy which it was designed to serve. Since the draftsmen assumed that investments in the first half of the base period are fully, or largely, reflected in the base period earnings, section 435 (f) makes no provision for those companies which invested capital funds in expanded production facilities more than 2 years before their first excess profits taxable year. The section overlooks the fact that, in many instances, such investments are not finally converted into production until after the end of the base period.

The inadequacy of section 435 (f) is particularly emphasized in the case of a fiscal year corporation which receives the credit for capital additions during the last 2 years prior to its first year subject to the excess profits tax, although its base period is reconstructed on a calendar year basis. The effect of this divergence from the reconstructed calendar year in the case of a company such as Pabco, which has a taxable year ending on June 30, is that Pabco receives credit for capital additions only during the last 18 months of its base period instead of during the last 24 months as is true for calendar year corporations.

I understand that the reason for the lack of uniformity was the fear of administrative difficulties in connection with capital additions in the base period by way of earnings and profits. It was apparently thought that fiscal year companies would not have adequate records of earnings and profits as of the end of the calendar years 1948 and 1949. This difficulty, if any, however, cannot apply to borrowed capital, and the importance of borrowed capital as a source of base period capital additions has been unfairly minimized.

Pabco Products is further harshly penalized. As it repays the borrowed capital, its excess profits credit will be reduced by 12 percent of 75 percent, or 9 percent, of the amounts repaid. Not only does the company receive no credit for the additional borrowed capital, but the inadequate excess-profits credit that it otherwise has is further diminished annually by the repayment of capital funds which were never reflected in its earnings base.

PROPOSED AMENDMENTS

At present the excess-profits tax seriously penalizes expanding corporations at a time when additional production is urgently needed. The relief provisions do not satisfactorily provide for the progressive corporation which, during the normal years of the base period, took the risk of investing additional capital funds in expanded productive capacity to meet the needs of the peacetime economy. In order to correct the inequity and remedy the oversight, a new subsection (4) should be added to section 444 (b) along the following lines:

"(4) Any increase in the taxpayer's capacity for production or operation consummated during any taxable year ending after the last day of the base period, as a result of the construction of additional facilities begun and continued during the base period, shall be deemed to be an increase in capacity in existence on the last day of the base period."

Respectfully submitted.

RANDOLPH E. PAUL.

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, D. C., August 2, 1951.

Hon. WALTER F. GEORGE,
Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR: Enclosed please find a copy of a resolution adopted or presented at a meeting of citizens in Memphis, Tenn., on July 27, 1951, concerning income taxes.

I have received numerous letters from my constituents enclosing me copies of this resolution, and if you will lay it before your committee for consideration I shall greatly appreciate it.

Thanking you and with best regards, I am

Sincerely your friend,

KENNETH MCKELLAR.

RESOLUTION PRESENTED AT A MEETING OF CITIZENS AT THE PEABODY HOTEL, MEMPHIS, TENN., JULY 27, 1951, AT 11:15 A. M. IN PROTEST TO THE RAISING OF ALL INCOME TAXES

Whereas the House of Representatives has passed a bill known as the Revenue Act of 1951 authorizing a straight 12½-percent increase in all existing income taxes collected by the Federal Government and imposing an additional 5-percent tax and raising excess-profits taxes up to 70 percent on the already overburdened and overtaxed business corporations of this Nation; and

Whereas our Government, while urging civilians to economize on manpower is squandering manpower (which is being increased at the rate of 1,900 Government employees per day) as in the case of 13,565 employees last year in the Bureau of Indian Affairs (one for every 30 Indians) and as in the case of 17,365 employed chauffeurs to drive our public servants around Washington, to enumerate two small items as examples of wasted manpower; and

Whereas there is general confusion, waste and inefficiency in our overwhelming bureaucracy as exemplified in the Federal Supply Services of the General Services Administration, which is divided into 4 branches, 17 sections, 27 units, 34 subunits, 13 groups, and 1 inquiry office; and

Whereas no new tax legislation would be needed if Congress would eliminate waste in Government spending and lending for nonessential projects, most of which the people do not need, do not want and cannot afford to pay for: Now therefore be it

Resolved, That in the interest of justice, equity and the preservation of our free Republic, we, the citizens of Memphis, gathered here to consider the Revenue Act of 1951, do condemn its passage by the House and petition our representatives in the United States Senate to defeat this measure which is socialistic in principle and destructive in purpose; and be it further

Resolved, That we, the taxpaying public, rise in righteous indignation and demand of our elected Representatives and Senators, that they shall first demonstrate a true measure of economy and efficiency before they request one additional cent of revenue from an already overtaxed public about to lose the last vestige of freedom and solvency: Be it further

Resolved, That we are opposed to the levying of any new Federal taxes whatever until every dollar of nonessential spending and lending is eliminated and then shold the levying of new taxes be judged sound and necessary that such taxes should be paid by all the people through a pay-as-you-go manufacturers' sales tax, and no further discriminatory or punitive taxes be assessed; and be it further

Resolved, That each citizen present will mail a copy of this resolution to the following Senators and Congressmen: Congressman Cliff H. Davis, House Office Building; Senators Kenneth D. McKellar and Estes Kefauver, Senate Office Building.

WOMAN'S DIVISION OF CHRISTIAN SERVICE,
OF THE BOARD OF MISSIONS AND
CHURCH EXTENSION OF THE METHODIST CHURCH,
New York 11, N. Y., August 1, 1951.

The Honorable WALTER F. GEORGE,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: If the tax withholding at source from dividends and interest which is proposed in chapter 6, H. R. 4473 is adopted and becomes part of our tax law, organizations which are by law exempt from Federal income tax will be adversely affected; income will be diminished, application of funds to the purposes for which they have been dedicated will be retarded and much-needed funds will be constantly frozen in the hands of the Treasury Department. Additional costs of operating will be imposed upon tax-free organizations in connection with the requisitioning, accounting and handling of funds.

It is hoped that tax withholding at source from dividends and interest will be eliminated from the tax bill when it is finally adopted. However, should this withholding or any portion of the proposal be retained, the attached suggestion of procedures for currently obtaining tax refunds would relieve some of the burden this withholding imposes on tax-free organizations.

Your consideration of the enclosed memorandum will be appreciated.

Respectfully yours,

HENRIETTA GIBSON,
Treasurer.

PROPOSED 20 PERCENT TAX WITHHOLDING AT SOURCE FROM DIVIDENDS AND BOND INTEREST

If the proposed tax withholding at source from dividends and interest becomes effective, and no exceptions are recognized at source, entities which are by law exempt from Federal income tax will be adversely affected. Income will be diminished, application of funds to religious, charitable, and educational purposes will be retarded and the actuarial basis for pension trusts will be seriously disturbed. Millions of dollars, representing tax refundable to tax-exempt entities, will be constantly frozen with the Treasury Department.

The procedure outlined below would relieve tax-exempt entities of some of the burden this proposed tax withholding at source would impose and provide all such entities with a means of obtaining a tax refund each month. The Ways and Means Committee of the House of Representatives, recognizing that refunds should be made to tax-exempt entities as quickly as possible, has proposed that such entities able to do so be permitted, each month, to offset, against funds held by them representing taxes withheld from wages for social security, and so forth, the tax withheld at source from dividends and interest. There are many tax-exempt entities which will not be able to obtain a tax refund in this manner; however, if the below-suggested procedure is permitted, all tax-exempt entities would receive like consideration.

SUGGESTED PROCEDURE

1. The tax-exempt entity would file with its depositary or depositaries a certification, verified by the Treasury Department, of its tax-exempt status. An acceptable form would be prescribed by the Treasury Department.

2. A dividend payment or interest payment order would be filed with corporations or their paying agents for all stocks and bonds registered in the name of the tax-exempt entity, so that all dividends and interest on such investments would be received through a depositary. All income on stocks and bonds owned by such an entity, but registered in the name of a nominee, and so forth, would be collected through the depositary, as would all interest on bonds held in coupon or bearer form. This procedure is suggested as a means of proof of receipt of income.

3. The depositaries, upon receipt of dividends and interest, representing 80 percent of the amount due, would credit the proper account of the tax-exempt

entity. Depositaries would be looked to for the correctness only of the dividends and interest on stocks and bonds held by them in custody. The correctness of all other income would be determined by the tax-exempt entity, with all necessary adjustments made through the proper account with its depositary.

4. Each month, the tax exempt entity would file with its depositary a certification (in duplicate), in such detail and form as prescribed by the Treasury Department, of the income its depositary has received and credited to its account during the month. This detailed certification would set forth the income due, the refundable tax withheld, and the net amount received, and would be checked by the depositary against its control records.

5. Attached to the certification statement submitted by the tax-exempt entity to the depositary would be a draft drawn on the Federal Reserve bank by the tax-exempt entity payable to the depositary for the account of such entity in the amount of the tax refundable. This draft would be in a form prescribed by the Treasury Department and would contain the endorsement and guarantee of the depositary similar to the following, or in a form to be prescribed by the Treasury Department:

"By endorsement of this draft, the depositary bank guarantees—

"(1) That the drawer has filed with the depositary bank a Treasury certificate evidencing its tax-exempt status.

"(2) That the draft has been signed by a duly authorized officer of the drawer.

"(3) That the proceeds have been credited to the drawer's account.

"(4) That the amount of the draft does not exceed 25% of the total interest and dividend payments credited to the drawer's account in the depositary bank during the preceding calendar month."

The draft would be presented by the depositary to the Federal Reserve bank accompanied by the duplicate copy of the tax-exempt entity's certification. If the Treasury Department would honor these drafts, it will result in the tax-exempt entities obtaining each month a refund of the tax withheld at source during the previous month.

WITHHELD TAX REFUND DRAFT

NEW YORK.............19.... 1–120
210

Pay to the order of
For account of

$............

.... Dollars

To—Federal Reserve Bank of New York,
Fiscal Agent for Treasurer of the United States.

....
(Authorized signature)

[See endorsement—reverse side]

[Reverse side]

By endorsement of this draft, the depositary bank guarantees—

(1) That the drawer has filed with the depositary bank a Treasury certificate evidencing its tax-exempt status.

(2) That the draft has been signed by a duly authorized officer of the drawer.

(3) That the proceeds have been credited to the drawer's account.

(4) That the amount of the draft does not exceed 25 percent of the total interest and dividend payments credited to the drawer's account in the depositary bank during the preceding calendar month.

Concerning interest on bonds, notes, etc., traded in between interest dates, the certification will always agree with the depositary's control if tax is withheld only on regular interest payment dates. If tax withholding on accrued interest is taken into account by buyer and seller on between-interest-date transactions, there will be certain instances where tax refunds requested in the certifications will be less than 25 percent of amount shown by the depositary's control as collected. For example:

A. Where a tax-exempt entity buys a bond, etc., between interest dates and holds the security at the next regular interest date, the refund requested would be based on the period such entity held the security.

B. Where a tax-exempt entity sells a bond, etc., between interest dates, providing such entity held the security on the previous regular interest payment date the tax refund requested will be 25 percent of the amount the depositary would show as collected, but if the security was not held on the previous regular interest payment date the refund requested would be based on the period the tax-exempt entity held the security.

C. It is recognized that where a tax-exempt entity sells bonds, notes, etc., between interest dates with adjustments made for tax withholdings, should such entity include in its certification for the month in which the sale took place a request for refund, such refund might be in advance of the month when the Treasury Department will collect the tax at source. In such instances, these items could be included in the certification for the month in which the regular interest date occurs.

D. Regarding tax-withholding on true discount notes, bills, etc., the method as to how the Government will want this income treated for tax withholding will first have to be determined and, based upon that determination, such amounts could be satisfactorily worked into the certification.

SUGGESTED PROCEDURE FOR THE SMALLER TAX-EXEMPT ENTITIES

The tax-exempt entity would deposit dividend payments, interest payments, etc., from which a 20-percent tax has been withheld in its local bank and simultaneously hand said bank a draft drawn on the Federal Reserve Bank as fiscal agent for the Treasury of the United States in the amount of the tax withheld at source from these specific dividend and interest payments, etc. This draft would contain endorsements similar to the following:

A. "By endorsement of this draft the drawer certifies—

"1. That it holds a good and valid ruling from the Treasury Department evidencing its tax-exempt status.

"2. That the proceeds have been credited to the account of the drawer.

"3. That the amount of the draft does not exceed 25 percent of the total interest and dividends, etc, from which tax has been withheld at source, which has been credited to the drawer's account simultaneously with this draft."

(B) "By endorsement of this draft the bank certifies—

"1. That the amount of interest, dividends, etc, noted above have been credited to the account of the drawer."

NATIONAL FEDERATION OF
STATE HIGH SCHOOL ATHLETIC ASSOCIATIONS,
Chicago, Ill., August 2, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR: Our organization, the National Federation of State High School Athletic Associations, is the governing body in athletics in the high schools in the 48 States. As such we are very much interested in the promotion of athletics in the high schools.

In the present tax bill, H. R. 4473, the excise tax is to be removed from such equipment as football, basketball, track, gymnasium equipment used principally by the schools, but it is proposed to continue the tax on baseball equipment, such as balls, bats, gloves, masks, body protectors, and leg guards.

It is the feeling of our association that the tax should also be removed from baseball equipment because this equipment is very important in carrying on our physical-training program in the schools, just the same as football, basketball, track, etc.

For a number of years, baseball in high schools was curtailed but because baseball fills such an important part in our physical training of boys in the ages of 12 to 17, our association initiated a program 5 years ago of increasing interest in the game.

For the 1950 year baseball was played in over 9,000 high schools with an estimated 200,000 students participating. In addition there are an additional 600,000 boys participating in informal baseball practice connected with the public school programs, making a total of 800,000 in all.

The public high schools can purchase their equipment free of excise tax, although there is considerable clerical work involved in the completing and filing of the excise-tax exemptions forms.

WITHHELD TAX REFUND DRAFT

New York ________ 19 ____ $\frac{1\text{-}120}{210}$

Pay to the Order of
for Account of

$ ____________

________________________________ Dollars

To - Federal Reserve Bank of New York
Fiscal Agent for
Treasurer of the United States

____
Authorized Signature

By Endorsement of this Draft the Drawer certifies
1-That it holds a good and valid ruling from the Treasury Department evidencing its tax-exempt status
2-That the proceeds have been credited to the account of the Drawer.
3-That the amount of this Draft does not exceed 25% of the total interest,dividends,etc. from which a 20% tax has been withheld at source and which have been credited to the account of the Drawer simultaneously with this Draft.

Dividend,Interest Payments,etc. Received From	Amount of Dividends,Interest etc.deposited simultaneously with this Draft 80% of Income Receivable	
Total		
25% of Total - Tax Refund also the amount of this Draft		

____
Authorized Signature

By endorsement of this Draft the Bank certifies that the amount of Interest, Dividends, etc. listed above have been credited to the account of the Drawer.

____
Authorized Signature

We respectfully request that baseball equipment be exempted from excise tax and thus relieve our school officials of the necessity of filing tax-exemption certificates. There will be no loss in revenue to the Government. As it is impossible for our associations to appear before your committee, it will be appreciated if this letter can be made a part of the record of the hearings.

Very truly yours,

H. V. PORTER, *Executive Secretary.*

LITTLE LEAGUE BASEBALL, INC.,
Williamsport, Pa., August 1, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: Thirteen years ago, there was created the Little League Baseball movement that is now growing rapidly and which sets up baseball leagues for boys from 9 to 12 years of age. There are over 50,000 boys now playing in these leagues.

We understand in the present tax bill, H. R. 4473, the excise tax on baseball is continued, though it is removed from other similar equipment.

We strongly urge that the tax be removed from baseball equipment, for the continuance of the tax at a 15 percent level, as proposed in H. R. 4473, would be a curtailing factor in the growth of the Little League Baseball, because of the increased cost produced by this tax.

The public schools can purchase their equipment free of the excise tax through a rather complicated procedure of filing an exemption form. This exemption, however, is not available to any organization such as the Little League.

Baseball has played a very important part in helping to curb juvenile delinquency in many areas and we are hopeful that your committee will favorably act upon the removal of the excise tax on baseball equipment.

We will appreciate it if you will include this letter as a part of the record of the hearings.

Yours very truly,

CARL E. STOTZ, *Commissioner.*

AFFILIATED GAS EQUIPMENT, INC.,
Cleveland, Ohio, August 2, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

MY DEAR SENATOR: In view of the limited time available to the Senate Finance Committee for hearings on H. R. 4473, the Revenue Act of 1951, we are setting forth in writing our views on amendment of the excess profits tax. We respectfully request that the committee give consideration to our letter and that it be incorporated into the record of the committee's hearings.

As you know, part II of the Excess Profits Tax Act of 1950 enables only "acquiring corporations," as defined in section 461 (a), to take into account the income credits of their predecessor companies in computing their own excess profits credits. Corporations acquiring their predecessors' assets and business in transactions other than those specifically described in section 461 (a) do not qualify for the benefits of part II.

Affiliated Gas Equipment, Inc., was incorporated in August 1948, and began business in January 1949, when it purchased for cash all the assets subject to all recorded liabilities of three wholly owned subsidiaries of Dresser Industries, Inc. This acquisition was not one of those described in section 461 (a). The three Dresser subsidiaries, Bryant Heater Co., Day & Night Manufacturing Co., and Payne Furnace Co., were the only gas-appliance subsidiaries of Dresser Industries, Inc., and shortly after the sale they were dissolved and Dresser withdrew from the gas-appliance field. Affiliated Gas Equipment, Inc., has continued to operate the plants of the three companies whose assets it purchased, and has continued to manufacture and sell gas appliances of the same general nature as were manufactured and sold by its three predecessor companies. Since Affiliated Gas Equipment is not entitled under the present provision of part II to use the income credit of the three predecessor companies and since it was in existence and doing business itself in only 1 year (1940) of the base period, it has had to make use of the "new corporation" relief provisions of section 445 in constructing an average base-period net income. This has not been wholly satisfactory, however, because the industry group in which it falls, "Primary metal industries and fabricated metal products (except ordnance, machinery, and transportation equipment)," is an extremely large and diversified group including metal industries from steel works to tin cans. The tentative industry rate of return for this broad industry group is 13.8 percent, which we believe is substantially lower than the rate would be on our industry if a more refined classification were employed. Since there is no general relief provision in the 1950 act, we have no opportunity to construct a more realistic income credit based upon the merits of our own particular case.

We, therefore, commend to the consideration of the committee an amendment of the Excess Profits Tax Act to broaden the definition of "acquiring corporations" to include at least companies acquiring, in a taxable transaction, all the assets and assuming the liabilities of predecessor companies where the predecessors dissolve after the sale and where the proceeds of the sale are not used in pursuit of the same business. For reasons set forth below, however, we consider it important that such an amendment provide an alternative credit to be used at the option of the taxpayer, and that the availability of the new credit provided by part II not withdraw from an eligible corporation its present right to construct a base period net income under the "new corporation" method of section 445.

Such an amendment would eliminate the penalty imposed by the present law on corporations such as Affiliated Gas Equipment, Inc., which are taxed on so-called excess profits which would not be excess had the predecessor companies been continued in existence or had they transferred their property to their successors in any of the types of corporate absorptions recognized in section 461 (a). In the case of Affiliated Gas Equipment, Inc., the excess-profits credit in 1950 would have been approximately $400,000 greater, and in 1951 would be approximately $600,000 greater, if the base period experience of its predecessors could be taken into account. This represents a direct tax penalty which its competitors do not have and which would have been avoided if it had purchased the stock of the three predecessor companies instead of their assets.

We also think, however, that it is important to realize that some taxable asset acquisitions involving new management and personnel may not represent a true extension of predecessor company base period income. In such cases, where the successor company is now entitled to the "new corporation" relief provision, it would certainly seem unfair to deprive it of its existing rights to its industry rate of return, and for that reason we strongly recommend that any amendment to part II to extend its provisions to taxable asset acquisitions be extended as an alternative credit which would not deprive "new corporations" of their existing rights to their industry rate of return.

To summarize, we recommend amendment of the Excess Profits Tax Act in the following two particulars:

(1) To include in the definition of "acquiring corporation" in part II at least companies acquiring all the assets and assuming the liabilities of one or more predecessor companies during or after the base period in taxable acquisitions where after the sale the predecessors discontinued business and dissolved; and

(2) To make available this new credit of part II on an optional basis to corporations otherwise entitled under existing law to the "new corporation" provision of section 445.

In conclusion, we appeal to the committee to provide relief from the inequities described herein in any proposed legislation which it may report.

Very truly yours,

PHILIP W. SCOTT, *Vice President.*

NEW YORK, N. Y., *August 3, 1951.*

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

The members and executive council of the Federation for Railway Progress respectfully urge your committee not to increase the already high surtax on the income of railroad companies. We estimate that the 5-percent increase in these taxes provided for in House bill 4473 which you are now considering would mean

$60 to $70 million additional annual tax burden for an industry already paying over a half billion dollars per year Federal income taxes. Instead of adding this new burden to railway industry, respectfully suggest this amount be realized by eliminating completely cash subsidies to airlines now running $40 to $70 million per year. These cash subsidies are in addition to hidden subsidies we estimate at close to $400 million per year which air transport industry enjoys. The millions of people who own and work for railroads are unable to understand why their industry which pays its own way in every respect must contribute an additional $70 million per year to Treasury while their airline competitors continue to draw an equal amount in unnecessary cash subsidies.

THOMAS J. DEEGAN, Jr.,
President, Federation for Railway Progress.

LITHOGRAPHERS NATIONAL ASSOCIATION, INC.,
New York, N. Y., August 2, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D. C.

DEAR SIR: On numerous occasions over the past years the Lithographers National Association has recorded with the Senate Finance Committee the facts with respect to the discriminatory burden placed upon this industry of small business enterprises by section 3406 (a) (4) of the revenue code which levies extremely high excise taxes on photographic equipment and film.

Among others we have pointed out the following facts:

1. That photographic equipment and film are tools of production and production supplies for lithographers.
2. The rate of these taxes was sharply increased under the Revenue Act of 1942 to a point where, taking into account the sharply increased cost price of photographic equipment, the actual tax in dollars is increased to more than 550 percent of the amount of the tax collectable prior to the passage of the 1942 act.
3. That the smaller lithographers bear the brunt of the taxes on film.
4. That the tax is inflationary.
5. That, if continued, the tax threatens the growth of this industry.

The purpose of this communication is to record our support of the proposals set forth in section 485 of H. R. 4473, which provides long-needed correction of the excises on photographic equipment and film, as well as to urge affirmative action on this proposal by the Committee on Finance and by the Senate.

We would appreciate it greatly if this letter could be made a part of the record in the current hearings.

Respectfully yours,

EDWARD D. MORRIS, *Secretary.*

STATEMENT OF E. J. BACHMAN, VICE PRESIDENT, JEFFERSON ISLAND SALT CO., LOUISVILLE, KY.

The total salt production in the United States for the peak war year of 1944, according to the United States Department of Interior, Bureau of Mines, was 15,717,171 short tons. The average yearly production of salt from 1944 to and including 1949 was 15,714,831 short tons, or within 2,340 short tons of the country's requirements during the last war.

Recent Government and industry estimates[1] point out that 10,000 tons of chlorine per day will be required by war industries by the end of 1951. In view of this, the Government has issued certificates of necessity for 3,121 tons of chlorine per day additional capacity and 319 more tons per day are under study. This additional chlorine capacity will require over 6,000 additional tons of salt per day, or an increased yearly capacity of over 2,000,000 tons of salt.

Synthetic-rubber plants, military installations, and expanding industry will also require more salt, which will substantially increase the 2,000,000-ton chlorine requirements.

In recent years there has been a negligible amount of capacity added to existing salt plants because the returns on this low-price commodity have not justified

[1] As reported in Chemical Industries, week of April 7, 1951.

the large investment required to produce additional salt. In order to alleviate the forthcoming shortage, it is essential that the salt producers be given stimulus for expansion and modernization of existing facilities and incentive to invest in additional productive capacity.

The most feasible way of providing this incentive is for the Federal Government to allow a percentage depletion on salt comparable to the depletion allowed on similar minerals, such as coal, oil, sulfur, phosphate, etc.

Based on statistics released by the Bureau of Mines in its 1949 Minerals Yearbook, the total value of naked salt produced in 1949 amounted to $54,048,220. Assuming a 50-percent cost of extraction, treatment, etc., for the industry and a 15-percent percentage-depletion allowance, disregarding possible interim excess-profits taxes, the cost to the Federal Government of this depletion allowance would be only about $1,500,000 per year. This is an insignificant figure when compared with the benefits to be derived from expanding the salt industry commensurate with the increased needs for salt during the present emergency.

It is, therefore, recommended that Congress provide for a 15-percent percentage-depletion allowance on salt by including the word "salt" in section 114 (b) (4) of the Internal Revenue Code of 1950 between the words "rock asphalt" and "phosphate rock."

WHEELING, W. VA., *August 2, 1951.*

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: The following statements are true and correct and will be attested to by the affidavit which follows the close of the statements.

Because of the fact that we were not in business prior to January 1, 1946 (having begun business on May 1, 1946), we cannot even use the growth factor but must be considered a new corporation which is given a credit equal to the return that the rest of its industry received on total assets. This, for a young fast-growing corporation, gives us nothing. We are not asking for any special privilege but simply that we be treated no differently than a corporation who began business January 1, 1946. We believe we are entitled to at least comparable consideration with such a concern.

In the case of a company such as ours, comprised of men who were experienced in the business and whose ability and experience permitted a rapid expansion of the business, any return on assets for the industry is entirely inadequate to measure the growth of our particular business. We believe that we should at least be permitted to use as favorable a method of determining our credit as are concerns who were in business prior to January 1, 1946. Those concerns can, if they meet certain requirements as to increase in sales or increases in payrolls during the last half of their base period—that is, 1948 and 1949 combined compared with 1946 and 1947 combined—use either the last half of their base period or the last year of their base period as their credit factor. This does give consideration to growth because if a company grew, then its growth would be reflected in the last half of its base period and especially in the last year of its base period.

We would be satisfied at least in some measure if we could do this, but we cannot because the growth provisions of the code provide that a firm such as ours, which is a new corporation, cannot use that provision. Therefore, even if we had a growth that was twice as good as our competitor who happened to be in business prior to January 1, 1946, we are stuck with an average base-period net income that takes into consideration a very low start and a very high finish in the base period; also, which gives no relief at all when comparing the return on our total assets with the return for the industry since we were probably the only member of our particular industry that had such a growth factor.

We believe that any corporation, no matter when they started business, should be permitted to use the growth factor if it could show that over four equal periods, beginning with the time it was incorporated and ending with the end of its base period, it had the type of growth provided for in the growth sections of the Excess Profits Tax Act. In other words, let us say we started business on May 1, 1946, and thus our base-period record could only be for 3 years, 8 months. That would be 44 months. We believe that if we can show that in the last 22 of those 44 months we had the same type of growth as that provided for in section 435 (e) for the "alternative based on growth," that we, too, should be permitted to use the same portion of our base period as the credit as is provided under that subsection for those firms who meet the growth factors. This would mean that if a firm had only a 2-year existence in the base period, if it could show in the last half of those 2 years—that is the last year compared with the first year—that it had the required growth factors, it, too, would be entitled to use whatever credits are provided for in the manner provided under section 435 (e) of the code. This would not be giving any firm any advantage, but simply giving a firm the same privilege as any other firm has who may have happened to have been organized prior to January 1, 1946. After all, if a firm does meet the growth factors, what is the difference how long it has been in business? It should be permitted to use a similar type of credit as any other firm may use under the same circumstances, even if the latter firm happens to have been in existence longer than the first firm.

We ask this in equity only and in fairness to a corporation whose growth has been phenomenal and who is continuing to grow. For instance, our experience, especially as shown by our 1950 fiscal year (October 1, 1949, to September 30, 1950) indicates that our base-period net earnings were as follows:

Year ended Sept. 30—	
1947	$117,442.58
1948	203,995.48
1949	359,799.15
1950	478,454.42

The foregoing figures are all before Federal income tax. Under normal conditions, if the foregoing were representative of four calendar years beginning January 1, 1946, under the growth formula permitted under section 435 (e) of the Internal Revenue Code, a firm with the above history of earnings (assuming, of course, that it met the growth factors as this firm does in both the case of sales and payrolls), we would have a credit of 85 percent of $478,454.42. Because our firm did not begin business until May 1, 1946, we are unable to calculate our credit by allowing for a growth factor, but must compute it under section 445 of the Internal Revenue Code as a new corporation. Because of the fact that our growth was far and away ahead of any increase in our assets, it is far better for us to simply average our income for the three full years we were in business during the base period rather than attempt to take a credit based on an industry return on total assets. Under these circumstances a firm like ours, which has had a much better growth than that even provided for under section 435 (e) of the Internal Revenue Code, comes up with a credit of 85 percent of $257,410.49 plus $31,171.04 for an increase in capital during the last 2 years of the base period. This results in a total credit of approximately $250,000, whereas, if we were permitted the same privilege of using the growth provisions of the code, our credit would be almost $407,000, or 60 percent more than the credit permitted us at present.

As an example of how this works, compared with our chief competitor in this area who has been in business for many years, we submit the following comparable information for our fiscal years ended September 30, 1947, to September 30, 1950, inclusive, with their calendar years ended December 31, 1946, to December 31, 1949, inclusive. The latter represents the base period for that company and the former represents the years out of which we carve the information for our base-period credit:

	Comparison of net sales		Comparison of taxable net profit before income taxes	
	Local competitor	Ours	Local competitor	Ours
Calendar year 1946 and fiscal year ended Sept. 30, 1947	$3,324,947.63	$644,955.98	$502,278.08	$117,442.58
Calendar year 1947 and fiscal year ended Sept. 30, 1948	4,828,958.89	1,012,798.63	1,076,530.89	203,995.48
Calendar year 1948 and fiscal year ended Sept. 30, 1949	5,218,776.13	1,633,728.54	1,063,889.06	359,799.15
Calendar year 1949 and fiscal year ended Sept. 30, 1950	4,674,663.45	2,183,187.92	729,850.99	478,454.42

In addition to the foregoing situation, our net sales for the 6 months ended March 31, 1951, amounted to $1,509,898.22 and our taxable net income, before income taxes, for the same period amounted to $359,746. This indicates a very decided continuance of our growth factor. The competitor's figures for the 1950 calendar year were net sales of $5,898,020.65 for the full year and profits, before income taxes, of approximately $947,535.35, also for the full year. I am a substantial stockholder in the competitor's business and have secured this information from the financial statements which they send me each year after the close of the calendar year.

On the basis of the foregoing figures, the competitor's credit, which takes into consideration an increase of $277,133.28 in net worth for the calendar year 1949 and an increase in net worth of $622,535.28 for the calendar year 1948, for excess-profits tax, will amount to approximately $884,000, whereas our credit is but about $250,000 despite the fact that within 6 months or a year our sales and our profits before taxes will probably be running on a par with the local competitor. We cannot see where there is any equity in a situation of that kind simply because our management has exerted tremendous efforts in developing the product and getting business. As soon as we reach the same level of earnings as our competitor we will be penalized at 30 percent of the difference between $250,000 and $884,000 on the basis of the same earnings as our competitor. That represents a slight penalty of about $190,000 when we reach that point. We believe that might be called materially unfair competition. To even give us the benefit of the growth factor permitted to other corporations who have been in business prior to January 1, 1946, would give us a credit of less than half that of our local competitor, but at least it will have been computed on the only growth basis permitted so far under the statute. Actually, we believe there should be a special relief section covering business which developed at a fast pace, such as ours, similar to the special relief granted under the Excess Profits Tax Act during World War II, which permitted a company to obtain special relief if its capacity for production or operation was materially increased during its base period.

Yours sincerely,

ALFRED BRIESE,
President, Pipe Coupling Manufacturers, Inc., Martins Ferry, Ohio.

STATE OF OHIO,
County of Belmont:

I, Alfred Briese, being duly sworn, do depose and say that I am president of Pipe Coupling Manufacturers, Inc., of Martins Ferry, Ohio, and that the facts and figures contained in the foregoing statement are true and correct.

ALFRED BRIESE.

Subscribed and sworn to before me this 2d day of August 1951.

[SEAL] MARIE E. OLIVER, *Notary Public.*

My commission expires November 8, 1953.

STATEMENT OF ROBERT A. GRANT, SOUTH BEND, IND.

This statement is submitted on behalf of the Ethanol Committee, an organization of users of ethyl alcohol engaged in the manufacture of medicinal and pharmaceutical products, together with the manufacturers of food products, flavors, and flavoring extracts. Together these represent the only two segments of the industry today who bear the tax burden imposed on the users of ethyl alcohol in the manufacture of nonbeverage products.

We appear here in support of section 462 of H. R. 4473, which is presently before your committee.

It was pointed out in my statement before the Committee on Ways and Means of the House of Representatives that, beginning in 1906, Congress recognized the necessity of making provision for industry to procure alcohol free of tax in the manufacture of many commodities which we use in our everyday life. This was accomplished by providing for the denaturation of the alcohol so as to make it unfit for beverage purposes. The list of items thus made today with tax-free alcohol would be far too long to recite in these hearings, but that list includes such things and processes as cellulose, resins, and related products, plastics, photographic materials, solvents, thinners, shellacs, toilet preparations, cleaning fluids, motor fuel, antifreeze, and the processing of industrial foods and other products.

Over and above the denatured alcohol above referred to, alcohol which is not denatured may be withdrawn free of tax and used by hospitals, sanitariums, clinics operated for charity, colleges, universities, and similar institutions in research and allied work.

It might seem there is no limit to the list of users of tax-free alcohol, but, Mr. Chairman, there is such a limit. And that is where we feel and have felt for years that there has been discrimination—discrimination against those who manufacture medicines and pharmaceutical preparations, and against the manufacturers of food products, flavors, and flavoring extracts. There are literally thousands of manufacturers who pay no tax at all upon the alcohol which is used in their products or their processes. In an average year there are about 325,000,000 proof gallons of alcohol withdrawn and used free of tax. But the makers of medicinal and pharmaceutical preparations, for example, use only about 2,000,000 proof gallons a year, or less than 1 percent of the amount of tax-free alcohol which is withdrawn and used under the present law. Let us consider this inequitable situation for just a moment. The alcohol contained in the antifreeze in your automobile or in a can of shellac is tax-free alcohol, but the alcohol which is contained in the spirits of ammonia, spirits of camphor, fluid extract cascara, or other medicinal preparations in your family medicine chest has been taxed at the net rate of $3 per proof gallon. This, of course, is accomplished by the payment of the tax at the regular rate of $9 per proof gallon at the time the alcohol is withdrawn, and then following the end of each calendar quarter we are permitted to make claim for refund, and upon our showing that such alcohol has gone into the manufacture of medicines or pharmaceutical products we are refunded $6 of the $9 paid. The result is that there are at all times between $10,000,000 and $12,000,000 of the proprietary medicine industry's funds tied up at the Alcohol Tax Unit and the net tax we pay is $3 per proof gallon.

About a year ago the House of Representatives recognized this inequity and wrote into the tax bill then under study a proposed amendment that would have increased the rate of draw-back to $7. That action would not have erased the inequity, but it was some indication on the part of the House of Representatives that an inequity did, and still does, exist and it offered some measure of relief in a much-needed direction.

That bill was, as we all know, sidetracked by the outbreak of war in Korea and an entirely new bill was substituted by this committee and that action was ratified by the Congress.

Mr. Chairman, we do not intend to be critical of the draw-back system. We commend the Bureau of Internal Revenue on the efficient manner in which it has administered this system. Then, too, we realize that we are dealing with a volatile chemical and there is, perhaps, a penalty which must be paid, because of possible diversion when in the hands of an unscrupulous user. It has been our earnest opinion that use of the draw-back system, tying up, as it does, millions of dollars of the industry's funds, without interest, is enough of a penalty to pay to guard against the possible abuse of the use of tax-free alcohol.

The Committee on Ways and Means supported by the House of Representatives has proposed by section 462 of the bill before us, to increase the draw-back to $9.50 out of a proposed tax of $10.50. We do not know what action the Finance Committee may take on the proposed increase of the alcohol tax, but whatever that action may be, we sincerely feel that the draw-backs permitted in these cases should, if possible, be in an amount equal to the full amount of the alcohol tax, but in no event should our net tax, after giving effect to the draw-back, be greater than the $1 as proposed in the House version of section 462 of H. R. 4473.

The Committee on Ways and Means in its report (pp. 38-39) indicates that the net tax of $1 per proof gallon is intended to cover the cost of administering the draw-back system. If it is the judgment of Congress at this time that the industry should bear the cost of administering the draw-back system, then we shall interpose no objection at this time on account of the great demand on our Federal finances occasioned by the hostilities in Korea. We shall only express our deep appreciation for the fact that recognition is now given that an inequity has existed and that relief from the major portion of that inequity is now being provided.

In closing, Mr. Chairman, we thank you and the members of the committee for your sympathetic consideration of the vital problem of these little industries affected.

To: Senators Carl Hayden and Ernest W. MacFarland.
From: Undersigned Arizona industry associations.
Date: July 9, 1951.
Subject: Currently proposed tax law; taxing of presently exempt sources.

The undersigned leaders of Arizona industry groups are among the many who have written Arizona's congressional delegates during the spring of this year to request that the new tax law take cognizance of the vast source of revenue now lying untapped in mutual savings and loan associations, properties owned by religious organizations, cooperatives, and other tax-exempt corporations. Our letters have been intended to protest the fact that these concerns pay no tax, or do not pay taxes equally with the businesses with which they compete.

We feel the bill formulated by the House Ways and Means Committee is grossly unfair to a great segment of American citizens who shoulder the daily increasing cost of Government. Incidentally, this segment is decreasing, because of the number who are converting to a tax-exempt status. We request your efforts to encourage the Senate Finance Committee to draft a measure taxing the presently exempt groups on an equal basis with other business concerns, and further request an effort on your part in behalf of the passage of such a measure.

It is our feeling that each unit (new industry and old taxpaying groups converted) added to the list of those who are exempt from taxation places an increasing load on a constantly diminishing source of tax income. Daily, going businesses are abandoning the role of taxpayers and joining the ranks of those who are exempt. One Arizona industry was recently approached for purchase by a tax-exempt organization which promised to pay an exorbitant purchase price readily from the great savings which would result from paying no taxes. To allow large business enterprises to avoid taxation by adopting the guise of charity, education, or cooperative venture, while yet doing business on an aggressively competitive scale with the general public, is to discourage individual initiative. Such discouragement of risk capital from the venture of private enterprise is destroying the philosophy expressed in our Constitution and is encouraging the collective philosophy of those countries with whom this Nation is now contending.

If the Senate Finance Committee will formulate and the Senators will work to pass a measure tapping this huge (exempt) pool of funds, and if our Congress will create meaningful measures to insure economy in nondefense spending, the pressure for new tax sources will have been removed.

Only such association leaders as are readily available in Phoenix at this time are signatory to this letter. More than double this number could be included if time permitted. We invite your attention to the number of business organizations involved and the many citizens employed by them and interested in their welfare.

The undersigned, representing thousands of Arizona citizens, take this means of asking you to go on record as to your attitude in this matter.

Lewis E. Haas, Manager, Phoenix Chamber of Commerce; Don Petty, Vice President, Air Conditioning and Sheet Metal Contractors' Association, 21 members; O. D. Miller, Chairman, Arizona Council of Associations, 41 member groups; D. H. Bonsall, Jr., President, Arizona Grain Dealers' Association, 14 members; Malcolm Strauss, President, Retail Jewelers' Association, 75 members; Frank Feffer, President, Arizona Chemical Association, 16 members; Claude Quebedeaux, Chairman, Arizona Tax Equality Association, 367 members; Frank Middleton, President, Arizona Association of Insurance Agents, 281 members; J. Davis Wynne, Executive Secretary, Arizona Hotel Association, 252 members; J. Earl Stowe, President, Arizona Tire Dealers' Association, 24 members; J. V. Guerin, Vice President, Arizona Implement Dealers' Association, 21 members; W. L. Kolberg, President, Laundry and Dry Cleaners' Association, 91 members; James C. O'Malley, President, Arizona Retail Lumber and Builders Supply Association, 150 members; Claude Stephens, Vice President, Arizona Automobile Dealers' Association, 193 members; Guy R. Cutler, President, Arizona Motor Transport Association, 80 members; Joe Banks, Manager, Arizona Restaurant Association, 160 members; Wm. Larson, Executive Secretary, Vegetable Growers' Association, 140 members; L. G. Vinson, President, Arizona Chapter, Associated General Contractors, of America, 73 members.

ROUND HILL, VA., *August 8, 1951.*

Senator GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: I wish to urge your careful consideration of section 117J of Revenue Code. I am asking no personal favoritism whatsoever. If the intention of the law is that purebred breeding cattle are ordinary income—so be it. If the intention of the law is that such cattle are to be regarded as capital gains after being held 1 year, I pray you say so clearly.

I feel it is little enough to expect the Congress to express its intention in language so clear that the Treasury cannot make fools of the taxpayers who are willing and try to pay taxes in accordance with the act of Congress. All the Commissioner seems interested in is to waste taxpayers' time, cause expense, and clutter the courts.

First, he ruled cattle 2 years of age or over are capital assets. Later, he ruled none are capital assets. We took our case to the Tax Court and got the absurd decision that females 20 months of age and males 34 months of age are capital assets (case 10 T. C. 1081). One month later the same court, in the case of A. Harold Schmidt and Albert H. Schmidt held that all breeding cattle 24 months old are subject to capital gains. The two cases are analogous. One can only conclude that the decisions are absurd and that the court is confused on the whole question, since 117J reads, 6 months of age or older.

The root of the confusion arises from the fact that section 117J uses the word "used" in the breeding herd. The Commissioner is so ignorant that he does not know we cannot use a female for breeding before she is 15 months of age, and males not before they are 18 months of age. These are laws of nature which must be observed unless we are to ruin cattle and produce runts. The young cattle are in and have to be held in the herd to these ages before they can be used in the breeding herd.

The House revenue bill of 1951 section 323 reads "such term includes livestock held by taxpayers for draft, breeding, or dairy purposes for 12 months or more." If this amendment is enacted and made retroactive to all years not barred by statute of limitations, it should end the confusion. It is possible even with this amendment that the Commissioner might argue that the cattle were not held for breeding purposes until they reached a certain age. This would be clarified if the amendment was made to read "livestock 12 months of age and held by taxpayers for draft, breeding, etc."

The Commissioner has gone to great length to avoid applying what appears to have been the intention of Congress in section 117J.

I am simply asking that you make the intention of Congress so clear, in such simple language, that a dumb commissioner and a confused court will have no choice but to follow that intention. We breeders are building the quality and quantity of cattle so badly needed and pay enormous taxes with no complaint. Are we not entitled to language clearly expressing the intentions of Congress so we do not have to waste our time fighting the Commissioner in the courts and wasting money that otherwise would produce additional taxes?

Sincerely yours,

WALTER S. FOX.

P. S.—The Revenue Bureau's ruling of April 18, 1951, is helpful as far as it goes. However, it confines capital gains to worn-out and defective animals and does not apply such treatment to the young animals (the new plant) from which the new and greater production is to come. Likewise it does not apply this treatment to breeding animals generally.

STATEMENT OF MARY BROOKS PICKEN

Mr. Chairman and members of the committee, some months back, I appeared before the House Ways and Means Committee when it considered and rejected a proposed excise tax on electric sewing machines. I explained to the gentlemen of the committee the importance of home sewing to the women of the country and pointed out the added burden that the tax would have on them. As the same proposal has been laid before the Senate Committee on Finance, I would like to place at your disposal my view as to the interest of women in this possible tax.

Practically all my life has been spent in teaching women and girls to sew. In Kansas many years ago I taught sewing in YWCA classes and later I gave sewing instructions to the women prisoners at the Federal penitentiary at Leavenworth. During the First World War, when there was a great upsurge of interest in home sewing, I wrote and directed the home-study courses in dressmaking for the Women's Institute, Scranton, Pa., where we taught more than 200,000 women to make their own clothes.

Since then I have written many books on sewing which are sold through the book stores to home women and used as textbooks in schools and colleges. I give you these details of my own experience because, through working with so many home women, I know how vitally important to them is the ability to make their own and their children's clothes and fabric furnishings for their homes. Because women sew primarily for reasons of economy and because it is the only way most of them can dress themselves and their children adequately, they should not be penalized with a burdensome tax on the tool that is so essential to their work.

Whenever we have a war, a depression, or other national emergency in this country, there is a great increase in home sewing. This is true because when the cost of living is high or the family income low, there is no other way by which a wife, a mother, or a girl at home or in business can meet the requirements of respectable living. Food prices go up, and no matter how thrifty a housewife may be, she must provide her family with three meals a day and it takes more money to do so. However, by doing her own sewing, she can actually have clothes for herself and her children at just about one-third of their cost ready-made.

I gave the members of the House committee a practical demonstration of the savings home sewing can offer to the hard-pressed housewife. I showed them a relatively simple cotton dress for a little girl which I had purchased in a New York department store for $10.95. It would have cost approximately the same amount anywhere in the country. I then displayed an identical dress that we had made up at home. The materials cost just $3.12, or less than one-third of the ready-made price. To a mother with several children to clothe that would be a very important saving. It should be remembered that there are far more children to clothe in the United States today than ever before. Since 1941 we have had one of the highest birth rates in history. Today there are approximately 20 million children in this country under 10 years of age.

Women sew for another reason—because of pride in their own appearance and in the attractiveness of their homes. A women who makes her own clothes can have three times as many or save two-thirds of their cost ready-made. The same ratio applies to slip covers, curtains, draperies, and other fabric furnishings.

Because women recognize these possible economies and because the dollar will buy so much less today, more women and girls are sewing than ever before. Sales of tissue paper dress patterns have more than doubled in the past 10 years. The four major pattern companies report a sale of 110 million last year. While speaking in millions—home women converted 120 million fabric feed sacks last year into garments for themselves and their children and articles for their homes. From this yardage in 120 million feed sacks, a sizable number of articles can be made. I understand these sacks are designed in some 50 to 60 patterns, thus giving women a wide choice.

A survey by the Women's Home Companion shows that 77 percent of its 4 million readers make some of their own clothes, 39 percent make more than half of their own clothes. A survey by McCall's magazine among 12,000 women who sew shows that they make an average of 27 garments per year.

The Government is trying to combat inflation, trying to get women to conserve materials, spend less, save more. I know of no one way in which all three of those objectives can be accomplished so effectively as by encouraging women to sew. The most essential item of equipment for that purpose is an electric sewing machine. A burdensome tax on that machine serves only to make it more difficult for a woman to own one or to place it entirely beyond her reach.

An electric sewing machine is not a luxury. It is a necessary piece of productive and money-saving equipment for the home today. It is a carefully considered purchase. It is bought for a lifetime of service and in most homes requires sacrifice to pay for. In my judgment the Government should avoid doing anything that will make its purchase more difficult or the sacrifice to obtain it a greater one. Therefore, I believe I speak for the interests of millions of home women all over this country when I urge that the proposed tax be not levied on electric sewing machines.

LUCAS & THOMAS,
Washington, D. C., August 3, 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: As special counsel for the Acacia Mutual Life Insurance Co. on tax and other legal matters, I have had occasion to read some of the testimony presented before the Finance Committee relative to H. R. 4473. In this letter I have reference particularly to the hearing of July 11 and the statements made by the three witnesses, Mr. John J. Magovern, Jr., of the Mutual Benefit Life Insurance Co.; Mr. Charles G. Dougherty, Metropolitan Life Insurance Co.; and Mr. Willis H. Satterthwaite, Penn Mutual Life Insurance Co.

These witnesses testified concerning the effect upon life insurance companies of the so-called tax withholding provided under section 201 of H. R. 4473, adding two new sections, 1200 and 1201, to the Internal Revenue Code. New section 1201 would require a 20 percent withholding in the case of certain dividend and interest payments. New section 1200 includes in the definition of interest "interest on amounts held by an insurance company under an agreement to pay interest thereon." These provisions would affect both certain payments made by a life-insurance company to its policyholders and beneficiaries and interest and dividends paid to the life-insurance companies on their investments.

The Acacia Mutual Life Insurance Co. is in complete agreement with the position taken by the three witnesses referred to above. We concur in all of the reasons set forth by these witnesses as a basis for their request that life-insurance companies be exempted from these proposed new provisions of the Internal Revenue Code.

In addition, there is a further point which we believe is of concern to the Government, and which has not been developed by any witness during the hearings; namely, that if this bill were enacted in its present form the withholding provisions thereof would result in a direct loss to the Government in the amount of income tax received from life-insurance companies. The income tax that each life insurance company pays is based upon the net investment income of the company; that is, interest and dividends from all sources less investment expenses and less an allowance for the interest required to maintain reserves and to fulfill other interest obligations to policyholders and beneficiaries. As the interest and dividends are received they in turn are invested to produce additional investment income. Deferring the time of such reinvestment because of the withholding plan, as pointed out by the three witnesses referred to above, would result in reducing the net investment income of each company. This in turn would mean a reduction of equal amount in the taxable income of each company and, consequently, a reduction of tax revenues received by the Government.

We do not have figures available for the entire life-insurance industry, but we do refer to the testimony of Mr. Charles G. Dougherty, of the Metropolitan Life, to indicate the amount of reduction in tax for that one company alone. At the end of Mr. Dougherty's testimony he points out that with respect to the Metropolitan Life Insurance Co. alone the proposed withholding program would result in a decrease in net investment income of $630,000 per year. Accordingly, the taxable income of the Metropolitan would be reduced by that amount and the income tax paid to the Government would be reduced proportionately. In other words, if there should be a tax rate of 50 percent the loss to the Government in income taxes on the Metropolitan Life alone would be $315,000 per year.

For all of the reasons advanced by the three witnesses who appeared before your committee on July 11 and for the additional reason set forth herein—namely, the loss of income-tax revenues from life-insurance companies which the enactment of section 201 of H. R. 4473 would cause the Government—we respectfully urge that payments made or received by life-insurance companies be exempted from the withholding provisions of H. R. 4473.

With best wishes, I am
Yours most sincerely,

SCOTT W. LUCAS.

STATEMENT OF JOSEPH A. SCHAFER, CERTIFIED PUBLIC ACCOUNTANT, WASHINGTON, D. C.

The desirability of simplifying the Federal tax system has been ignored under pressure of heavy demands for additional taxes. In the hunt for tax dollars every source of income is placed under the spotlight, so that eventually everything under the sun contributes its share to the cost of human relationships in domestic and international affairs. In the course of expansion there have arisen confusion and complications, duplication, and wastage, and inconsistencies and injustices.

When taxation becomes burdensome and oppressive, proper principles must be sought and applied, such as the following:

1. The taxes imposed must be just and equitable to all classes of citizens.
2. The system must be practical and as simple as possible, in order that collection of the revenue will be at the lowest cost, and also that it will cause the least distraction and disturbance to the taxpayers.

The revenue bill of 1951 (H. R. 4473) violates those principles because it creates new complications and will greatly increase the cost of collection and administration, and for the following specific reasons:

1. Individual tax rates are exorbitant and confiscatory in the high-income brackets.
2. Benefits allowed to heads of households and those filing joint returns are unfair to the low-income groups.
3. Withholding on dividends and interest, as proposed, will be an intolerable imposition upon those persons who owe no tax.
4. Expansion of the system, as proposed, will cause considerable unnecessary work for corporations and the Government, and will result in increasing administrative costs to the extent of millions of dollars, and the wastage of manpower and critical materials, supplies, and services.
5. Corporation income tax rates under the present method of computation are extremely inflationary.
6. Excise tax changes continue a discriminatory system.

INDIVIDUAL TAX RATES

The special limitation on tax provision has been increased from 80 percent in 1950 and 87 percent in 1951 to 90 percent as proposed for 1952. The latter limitation percentage would permit a person who earned taxable net income of $500,000 in 1952 to retain $50,000. That concession, however, does not take into consideration the relationship, duplication, and superimposition of other taxes.

State personal income-tax rates reach up to 10 percent. In many States sales taxes are 2 or 3 percent. Federal excise taxes are 20 percent on many items. Sales and excise taxes cannot be considered to be anything but a tax on income which is being spent for some commodity or service. The combination of those taxes establishes a system of double and triple taxation on personal incomes to such an extent that it constitutes unreasonable seizure of property.

The combined rate for income and defense taxes on all income over $90,000 in 1952 would be 91.5 percent, but if a State income tax of 10 percent is added the rate becomes 101.5 percent. Assuming for that level of income that the taxpayer spends $1,000 of his earnings for goods which are subject to 3 percent State sales tax and 20 percent Federal excise tax, he would have to pay an additional tax of $230 besides the income taxes of $1,045, or a total of $1,275.

In other words, for every $1,000 of earned income that was spent, it would be necessary to earn an additional $1,275 representing the tax dollars. An effective tax rate of 127½ percent violates the principle of tax limitation. Incomes over $90,000, therefore, will be subject to penalty taxation. Such a condition is outright confiscation of earnings and capital.

True limitation of taxes on personal incomes should provide that at any rate no more than 100 percent of income can be demanded from taxpayers for the combined Federal and State income, excise, and sales taxes.

JOINT RETURNS AND HEAD OF HOUSEHOLD BENEFIT

In order to equalize the tax advantage previously enjoyed by husbands and wives in community-property States, the splitting of income on joint returns was extended in 1948 to married couples in all States. It now is proposed that a portion of that benefit should also apply to persons who must maintain a household. This is a relief measure that is warranted because of the hardship which might exist, as in the case of a parent who must maintain a home for a small child.

The benefit of income splitting and the relief now proposed for a family unit, however, do not include all groups because of technical limitations. If hardship is to alleviated, then it should apply to all in that category without discrimination.

Reference to the 1951 tax table will show that a married couple filing a joint return receives no benefit if they have less than $3,000 adjusted gross income. A married couple with a child receives no benefit if they have less than $4,300 adjusted gross income. For adjusted gross incomes from $3,000 to $5,000 the benefits to a married couple range from $1 to $25, while the benefits to a married couple with a child range from $1 to $13 for adjusted gross incomes from $4,300 to $5,000.

In the same manner the tax tables presented in the House bill do not give any benefit to a head of the household with one dependent for adjusted gross income less than $3,050. If there are two dependents, the head of the household would obtain no benefit if adjusted gross income is less than $4,250. For adjusted gross incomes from $3,050 to $5,000 the benefits to a head of the household with one dependent range from $2 to $14, while the benefits for two dependents range from $1 to $8 for adjusted gross incomes from $4,250 to $5,000.

Consequently, married couples and heads of households obtain no benefits if they are in the low-income groups, those having three exemptions obtain less benefit than those having two exemptions in the benefited brackets up to $5,000 adjusted gross income; and those having four to seven exemptions obtain no benefit whatever up to $5,000 on the tax tables. It would seem that those family units in the low-income groups and those with additional dependents have a greater burden to bear and therefore are entitled to greater relief than those in the higher income groups.

Based on changes proposed in the House bill, the following figures show the increase or decrease of income tax for the year 1952 (12½ percent over the 1951 tax) for various amounts of income involving a family unit of two persons:

Adjusted gross income	Single person with 1 dependent	Head of household with 1 dependent	Married couple, no dependent
$2,000 to $2,025	$16.00	$16.00	$16.00
$3,000 to $3,050	51.00	51.00	51.00
$3,050 to $5,000	55.00	71.00	81.00
$12,000	321.50	83.00	208.50
$25,000	1,190.25	−349.75	840.50
$50,000	3,151.50	−302.25	2,378.25

All groups shown above will pay an increased amount of taxes in 1952 except the higher-income head-of-the-household groups, which will pay less tax in 1952 than in 1951.

To extend benefits to heads of households and to married couples in the low-income groups it is recommended that a special personal exemption in the amount of $300 be granted to those categories. Heads of households in all income brackets would be entitled to the special allowance. There would be no special adjustment in surtax rates. With respect to married couples with less than $5,000 adjusted gross income, the special allowance of $300 would be in addition to the splitting of income on joint returns.

Based on allowance of the $300 special extemption to heads of households in all income brackets, and to married couples with less than $5,000 adjusted gross income, the following figures show the increase or decrease (—) of income tax for the year 1952 (12½ percent over the 1951 tax) for various amounts of income involving a family unit of two persons:

Adjusted gross income	Single person with 1 dependent	Head of household with 1 dependent	Married couple, no dependent
$2,000 to $2,025	$10.00	[1]—$32.00	[1]—$32.00
[illegible] to $3,000	51.00	[1]—17.00	[1]—16.00
$4,950 to $5,000	85.00	[1] 11.00	[1] 14.00
$12,000	321.50	[1] 256.75	278.00
$25,000	1,190.25	[1] 981.12	840.00
$50,000	3,154.00	[1] 2,911.00	2,875.25

[1] Benefited by $600 special exemption.

WITHHOLDING ON DIVIDENDS

The House bill provides that a tax of 20 percent shall be withheld by every person who pays out dividends after December 31, 1951. There will be no allowance for personal exemptions for individuals as in the case of salaries and wages.

Withholding will be required where the recipients are individuals, partnerships, estates, trusts, corporations, regulated investment companies, personal holding companies, tax-exempt organizations, and governmental bodies.

On the other hand, no withholding will be required on dividends paid by Federal banking institutions because such dividends are received entirely by corporations. And no withholding will apply for dividends paid within an affiliated group of corporations which file a consolidated return. Likewise exempt from withholding will be governments, political subdivisions, international organizations, and their agencies or instrumentalities, if they own the entire class of stock for which the dividends were paid, for the reason that withholding would serve no useful purpose.

Withholding on dividends is desirable, and ordinarily would be a simple matter for the corporation payors. However, the system proposed in the House bill is objectionable because—

1. As to individuals, it would cause untold annoyance and hardship to persons in the low-income groups who owe little or no tax.
2. The requirements relating to corporations and other organizations are extremely cumbersome, complicated, and impracticable, and would serve no useful purpose.

As to individuals

In the case of individuals it should be noted that many persons receive income only from dividends during the course of the year. And in many cases the total income received is not in excess of the total exemptions so that no tax is due. In other cases the exemption amount offsets only part of the income and only a small amount of tax is due. In those cases it is probable that the person who depends on the regular receipt of dividend income for subsistance operates on a close budget, and consequently any diminution of receipts because of withheld tax would deprive that person of the necessities and essentials of life.

On $1,000 dividend income during the year, $200 would be withheld by the corporations for the 20 percent tax, so that only $800 would be received. The $200 reduction in receipts during the present high cost of living period cannot be other than a severe hardship to those people. Such a state of affairs is intolerable and must be condemned as an unjust and unwarranted imposition on the citizens.

Permission to obtain a refund of the wrongfully withheld tax would not alleviate the inconvenience and suffering that would be caused, because the withholding would be a recurring matter and would overlap from one year to the next. That is, the Government would always be in possession of funds belonging to those persons, without interest, and some of it for longer than a full year. In the case of older persons it is certain that they would never have the benefit of the withheld portion of their income during the last year of their lives.

The conditions recited above could be overcome by the simple process of allowing recipients of dividends to file certificates for the number of exemptions to which they are entitled. The exemption certificates would be filed with the corporation or other payors of dividends in the same manner that is in effect for the filing of employees' withholding exemption certificates with employers in connection with the collection of income tax at the source on wages. Then, if a person receiving $1,000 from dividends during a year was entitled to two exemptions totaling $1,200, no amount would be withheld because no tax was due for that year.

This procedure should apply only to those who file certificates for their allowable exemptions. But withholding from individuals would be required in every case where no exemption certificate was filed.

As to corporations and other organizations

The withholding system for dividends should apply only to individuals and not to corporations or other organizations. If no withholding by Federal banking institutions will be required because dividends paid by them are received entirely by corporations, then it would seem just as logical to eliminate from withholding all dividends paid to corporations, in every case and whether or not they are related or affiliated.

Furthermore, corporations and governmental bodies are specifically exempted from withholding on their royalty income. Also exempted as interest paid on equipment trust certificates because they are ordinarily held by corporations.

It should be noted that corporations are on a different tax basis than individuals, and also that their financial records generally are satisfactory and complete with respect to all transactions. The theory that income is unreported because of evasion, forgetfulness, carelessness, and a failure to keep records, does not usually apply to corporations and other organizations.

The exemption from withholding, because no useful purpose would be served, in the case of dividends paid to governments or their agencies, etc., if they own the entire class of stock, seems to be subject to an arbitrary restriction, because if no useful purpose is served in such case, then presumably no useful purpose would be served if they own only 50 or 25 percent or any other percentage of a corporation's stock.

Special rules are proposed for withholding on dividends paid to regulated investment companies, personal holding companies, tax-exempt organizations, and governmental bodies. In those cases, it is believed outright exemption of payments would greatly complicate the work of the withholding agent. It is difficult to see how exemption of those classes would create complications. On the other hand, the complications created by the special rules could not be worse.

It is recognized by the House committee that such withholdings would interfere with current operations of those organizations, because they must disburse practically all of their receipts, so they would be given credit for any withholdings from their dividend income, which credit they could apply against any payment due by them for income and payroll taxes and against amounts they themselves had withheld from their own dividend disbursements. The credit is limited to the amount of the liability for taxes or withholdings, and any excess credit over the liability would be recoverable upon the filing of refund claims quarterly or otherwise.

In the case of a tax-exempt organization, for example, an amount first of all would be withheld from its dividend income, then it would subsequently have to claim a credit therefor when it filed its payroll tax returns or income tax return, and if a balance of credit remained it would have to file a claim for the refund of that amount. If it desired it could file a claim at the end of each quarterly period for the balance due it. Such useless procedures can only cause more confusion and create unnecessary work all around.

WITHHOLDING ON INTEREST

The above criticisms with respect to withholding on dividends also apply to interest income as the procedures are alike.

Exemption from withholding on interest income is provided by the House bill in connection with equipment trust certificates, United States savings bonds, postal savings certificates of deposit, bank deposits and savings accounts, and payments on accounts in other financial associations.

In order to assure collection of tax on all sources of income, the above items should not be exempted from withholding in the case of individuals.

Upon the cashing in of savings bonds or certificates of deposit it would be a simple matter to withhold tax on the interest income, for which a receipt form could be filled out and given to the individual by the financial institution. With respect to interest earned on bank deposits and savings accounts, the system should provide for withholding of tax on the income at the time the interest is credited in the account, an offsetting charge being entered for the tax withheld and a receipt form given therefor. On small accounts it could be provided that no tax less than $1 should be withheld on interest credited, but that withholding should be deferred until a withdrawal is made or the account closed out.

PENSIONS AND ANNUITIES

No provision is made in the House bill for withholding of tax relating to income from pensions and annuities. Aside from the probability that some income from those sources is unreported in tax returns and thus escapes taxation, the withholding by corporation payers of tax on such income would be a great relief to taxpayers.

To the average taxpayer no item to be reported is more confusing than pensions and annuities. In the determination of the proper amount to report for such income it has always been necessary to provide a special schedule in the tax return. The confusion arises because several factors must be taken into account, such as cost basis, the portion of past receipts that was taxed and the portion that was tax-free, and the computation of the portion of the current year's receipts that constitutes taxable income.

It should be obvious that the corporations paying out pensions and annuities are in a much better position to determine the correct amount of such taxable income since they have all the essential information available in their records. Therefore, it would seem desirable for corporations to withhold tax on pension and annuity income at the source. Such procedure would assure better collection of tax on those sources of income, and at the same time would relieve taxpayers of one of the most confusing aspects involved in filing tax returns.

THE WITHHOLDING SYSTEM

Expansion of the withholding system to dividends, interest, and royalties should be limited to the payment of such income to individuals. All payments to corporations and other organizations should be exempted from withholding. Otherwise the withholding agents, as well as the corporation recipients and the Government, will have thrust upon them additional work and expense that is unnecessary.

The extra expense will be incurred in connection with the collection, recording, accounting, reporting, and payment of the withheld funds by the payers, recipients, and Government. If the receiving and disbursing of the withholdings will involve 600,000 corporations, the importance of keeping added burdens to a minimum must be realized.

Internal Revenue Bureau statistics on corporation income tax returns for a prior year reveal that less than 500,000 active corporations paid out dividends totaling $7.5 billion, and received dividends from domestic corporations in the total amount of $1.7 billion. Assuming dividends of $2 billion paid by corporations to other corporations, the withholding at 20 percent would equal $400 million. Using only active corporations, it would take an average over-all cost of $800 per corporation to match total withholdings. If that were the case then the additional costs would equal the tax withheld.

With respect to regulated investment companies and tax-exempt organizations, the special rules for the claiming of credit for withheld taxes by application to payroll and income taxes, or the filing of quarterly refund claims for excess credit balances, will cause complications and confusion.

Adding insult to injury for the poor taxpayers whose gross income is less than $600 and who therefore would not have to file a tax return because they would owe no tax, is the provision in the House bill which would permit them to wait 7 years to file a claim for refund, without interest, for tax withheld on their income from dividends, interest, and royalties. But the poor taxpayer would have to keep careful account of his withholdings during the 7 years because it appears that a refund under that provision could not exceed $2 for the taxable year. This seems to be one of the most impracticable provisions of tax law ever written.

The requirement that withholding must apply to the full amount of the dividend or interest without regard to offsetting exemptions will result in the filing of perhaps 3,000,000 additional refund claims each year. More than 90 percent of those additional refunds will involve individuals who have also received salaries or wages, the withholdings from the latter sources having taken into consideration allowable exemptions and the standard deduction. The other additional refunds will involve those whose only sources of income are dividends and interest and who will owe less tax than that withheld, or no tax, depending upon their exemptions.

According to statistics for the fiscal year 1949, 36½ million income-tax returns were treated as refund claims because of excess withholding of tax on salaries and wages. Including 2 million claims on Form 843, the total amount repaid to all classes of taxpayers by the Government was $2.9 billion, which included interest. It has been reported that refund checks amount to as little as 3 cents and 30 cents. At an estimated cost of $10 per refund, the extravagance of such a system becomes apparent. It may be correct to state that the cost of refunding excess withholdings amounts to as much as the total amount refunded. Therefore, instead of expanding the system in such a manner that the number of refunds will be increased, it would seem expedient to revise the withholding system in order to eliminate the necessity for refunding overpayments.

Of vital importance during the present emergency is not only the costliness of an improper system, which because of higher prices adds greatly to the cost of administration, but the utter disregard for the squandering of manpower and the unnecessary wastage of critical materials and supplies. The Commissioner of Internal Revenue has stated: "We should strive toward seeing that the taxes are obtained with the least possible drain on our manpower and supplies in their administration. * * * Not only is manpower vital for defense purposes, but also supplies of various types."

Suggested simplification

An attempt is made in the House bill to have the tax withheld on wages during the year equal the actual tax liability of the taxpayer. That would be accomplished by voluntary agreement between the employer and employee, according to regulations to be prescribed as to the conditions and the extent deemed proper. Pending issuance of regulations it is not certain whether that provision will permit an employee to calculate his tax before the end of the year on all his income, and then inform his employer of the correct balance due which should be withheld from the last salary payment for that year. Would the employee be permitted to include in his calculation sources of income other than wages, such as dividends and interest? And instead of additional withholding, would it be possible to inform the employer that a lesser amount should be withheld on the final salary payment in order that total withholdings will equal the tax liability and thus make unnecessary the obtaining of a refund for overpayment of tax?

If such procedure is practicable for employers and employees, so that withholdings equal tax liability, then another step could be taken by eliminating the requirement that those persons file a return on which the year's figures are reported. This could be made applicable to those who elect to file Form 1040A as an optional individual income-tax return, and on which the tax is computed by the Collector of Internal Revenue. Filing under this method is provided for under supplement T, which relieves individuals of the task of computing the tax on the income reported if their gross income is less than $5,000 and entirely from wages, dividends, and interest subject to withholding.

Under those circumstances it should not be necessary for employees to file Form 1040A for the year involved, but instead a "substituted" Form 1040A could be filed for the employees by the employer at the close of the year. The "substituted" return would combine the withholding statement (Form W-2), on which total wages and tax withheld are reported for the year, and the employee's withholding exemption certificate (Form W-4), on which personal exemptions are claimed.

The revised form combining the present Forms W-2 and W-4 would show the names and addresses of the employer and employee, a detailed listing of every person claimed as an exemption, the total number of exemptions and certification thereof, the total wages paid during the year, and the total tax withheld. The original copy of the revised form would be designated "Collector's copy," the duplicate "Employee's copy," and if necessary a triplicate copy could be retained by the employer.

The detailed procedure would be as follows:

1. At the beginning of the year the employee would list his dependents and exemptions on the revised Form W-2/4, which then would be retained by the employer.

2. At the end of the year the employer would complete the revised Form W2/4 by inserting in the spaces provided therefor the total wages and tax withheld for the year.

3. The original copy of the form would be mailed to the Collector as the employee's tax return and the duplicate would be given to the employee. No further action would be required of the employee.

4. The Collector also would receive information returns from corporations reporting payments of dividends or interest to the employee during the year and the tax withheld thereon.

5. All forms relating to a taxpayer would be assembled, and subsequently the Collector would compute the tax on the various items of income reported to prove that the correct amount of tax had been withheld and collected. In case of discrepancy a bill could be sent to the taxpayer.

Correlation between the sections providing for voluntary agreement on withholding and the use of optional tax return, Form 1040A, would effect a major step in the simplification of the system for collection of tax at the source. If the taxpayer can be relieved of the task of filing a tax return because the correct amount was withheld, it would not only be of the greatest convenience to him, but a tremendous saving would result from the elimination of millions of forms and all the work connected with their filing, processing, reviewing, examining, transporting, storing, and other tasks.

On the basis of practically 36 million tax returns with adjusted gross income under $5,000 as shown by the House committee report, it can be estimated that about 20 million would report salaries or wages only, while an additional 2 million would report dividends and/or interest along with salary or wage income. If 20 million tax returns can be eliminated at an over-all cost of $5 per return (for paper, printing, processing, transportation, etc.), the saving to the Government would be $100 million. And if 20 million refunds for excess withholdings are eliminated at an over-all cost of $10 per refund, another $200 million would be saved. Such savings in the total amount of $300 million certainly make the attempt at simplification worth while.

Alternative method

The above procedures are adapted from the revised tax-collection system which I have been advocating for 4 years, but they entail only part of the program. In order to prevent the escape of tax on certain sources of income and therefore make it possible to collect the maximum tax due the Government at the lowest cost of administration, my plan provided for the following:

1. Expansion of the income-tax-withholding system to include wages of domestic workers and agricultural labor by correlation with the social-security-tax-withholding system.

2. Expansion of the withholding system to include income from dividends, interest, pensions, and annuities, to which now can be added royalties.

3. Operation of the withholding system in such a manner that the tax withheld would be the actual tax due on the related income, instead of the present method of withholding the incorrect amount of tax all during the year.

4. Elimination of the requirement for filing tax returns to apply to taxpayers having adjusted gross income under $5,000 from the various sources of income to be included in the expanded system.

As that plan would assure complete collection of tax on those sources of income, there would be no point in their filing tax returns. Since 90 percent of the taxpayers having adjusted gross income under $5,000 would thus be fully paid up on their tax liability, more than 30 million tax returns could be dispensed with, as well as perhaps 20 million refunds. The total saving to the Government then would be $350 million, not to mention the saving of vitally needed manpower and critical materials and supplies.

More important is the probability that expansion of the withholding system to cover all individuals receiving salaries, wages, dividends, interest, pensions, annuities, and royalties would result in the collection of perhaps $1 billion of additional income taxes, it being estimated that from $1 to $1½ billion of tax liabilities are neither reported nor uncovered at present.

The procedure to withhold the correct tax during the course of the year, by splitting the mathematical process into two parts, the taxable and exempt income portions, and the application of the tax rate, is as follows:

1. A taxpayer would be allowed to receive tax-free, without withholding, as much income as would equal the total amount of his exemptions. That is, if an employee was entitled to two exemptions, the first $1,200 of his salary would not be subject to withholding, but after the value of his exemptions had been absorbed, tax would be withheld on every dollar of his earnings during the remainder of the year.

2. A taxpayer receiving dividend income in addition to salary would have his allowable exemptions absorbed by his salary earnings and therefore the full amount of dividends whenever paid to him during the year would be subject to withholding. But if a taxpayer had only dividend income and no salary income, he should be permitted to file an exemption certificate with the payor corporation so that he can receive tax-free income to the extent of his exemption.

3. The tax withheld on income during the taxable part of the year would be determined by application of a single effective rate, which would take into account the various factors involved in the computation of income tax—the normal tax, surtax, and defense tax rates, and deductions for contributions, interest, taxes, medical expenses, and other losses and expenses. The single rate would apply to only the first bracket of income, which could be fixed at $3,600 to conform to the basis of the social-security tax, as a matter of convenience to the employer, instead of extending the first bracket to $5,000.

4. A taxpayer would be permitted to file a tax return at the end of the year in order to adjust his tax payments because of error, extraordinary deductions, or special conditions which prevented correct withholding during the year.

For example, an employee entitled to two exemptions ($1,200) and earning $50 salary per week would receive the full amount free of the withholding deduction for the first 24 weeks, at which time his $1,200 exemption would be fully absorbed. Thereafter he would enter the taxable period and every dollar of his earnings would be subject to withholding. Assuming an effective rate of 20 percent (which would automatically provide for the standard deduction and the defense tax), the tax withheld on the $50 weekly salary would amount to $10 for each of the final 28 weeks of the year, or a total of $280, which would correspond to the total tax otherwise computed for the year. In that event the tax withheld would equal the actual tax liability so the filing of a tax return would be unnecessary.

The above is merely a general outline of the plan I have proposed. For a thorough understanding of the detailed procedures, including special situations and all the related problems, reference may be made to my original article, The Withholding System Needs Revision, which was published in the May 1948 issue of Taxes—The Tax Magazine, and a supplemental article, Is it Time to Revise the Withholding System?, which was published in the September 1949 issue of that magazine.

CORPORATION INCOME TAXES

The House bill increases corporation income taxes from 47 to 52 percent. Although the rate increase is only 5 points, the inflationary effect will be almost three times greater than the increase in the direct tax element. That arises because of the method of computing corporation income taxes.

Assuming that corporations are required to pay dividends aggregating $8 billion for the use of the invested funds of stockholders, at a 52 percent rate it would be necessary that they earn more than twice that amount because Federal income taxes first must be paid. The following figures show a comparison of the 1951 rate of 47 percent and the proposed rate of 52 percent:

	47 percent rate	52 percent rate	Increase
	Millions	*Millions*	*Millions*
Taxable net income required	$15,094	$16,666	$1,572
Corporation income taxes	7,094	8,666	1,572
Balance left for dividends	8,000	8,000	

At 52 percent corporations would have to earn $16.6 billion net income in order to pay $8.6 billion tax and have $8 billion left with which to pay dividends.

Since the $8 billion of dividends is part of the net income, the direct tax on that $8 billion portion is the true tax element for the purpose of this illustration, and the difference between that and the actual corporation income taxes shown above represents the differential which must be made up. The composition of the corporation tax is as follows:

[In millions]

	47 percent rate	52 percent rate	Increase
Corporation income taxes (above)	$7,094	$8,666	$1,572
Direct tax on $8 billion of net income representing dividends	3,760	4,160	400
Differential	3,334	4,506	1,172

These figures show that the direct-tax element increased $400 million, but that the differential needed to make up the actual tax increased almost $1,200 million.

It must be recognized that all costs, expenses, taxes, dividends, and reserve profits must be obtained in the first place through the prices charged to consumers. Therefore, the entire amount of tax, including the direct-tax element as well as the differential must be recovered from them. This means that for an increase of five points in the tax rate, prices to consumers must be inflated $1,200 million beyond the direct-tax element.

That amount, however, must be more than doubled because the dividend portion used as a basis in the above calculation ordinarily represents less than 50 percent of the net income, as reserves, expansion, and other commitments must also be provided for. Consequently, it can be stated that prices and the cost of living for 1 year will be inflated $2½ billion.

In order to overcome that severe inflationary burden on the customers it is recommended that corporations compute their income taxes on the balance of net income after the deduction of dividends paid to stockholders. In that event the balance of net income after dividends could be shared by the Government, but only after providing for reserves, expansion, and other commitments. That method could provide a substitute for the very complicated excess profits tax system, and at the same time it could be used to control prices. That is, if prices increased 10 percent, the tax rate could be increased proportionately in order to extract the profit which had resulted from unwarranted or exorbitant price rises.

EXCISE TAXES

The change suggested above in the method of computing corporation income taxes would make it possible to abolish excise taxes (except those of a regulatory nature). The $2 billion of excises charged to corporations then would be replaced by taxes that are based on net income that has been earned.

Otherwise, the excise tax system will continue to discriminate against the people and also goods and services, it will continue to disrupt and interfere with business; and it will continue to deprive certain people of goods and services. The inconsistencies presented by the House committee point out the arbitrary results of any attempted adjustment of a faulty system.

It is proposed to exempt photographic items used in business because "a tax on business cost items is likely to be shifted forward as an operating expense and thus appear in the price of commodities." That also should apply to many other items now taxed which positively will be added to costs and prices, such as communication and transportation expenses, leather goods, equipment, and other items used for business purposes. But the tax on trucks is being increased.

It is proposed that the 3⅓ percent tax on electrical energy be repealed because it is "one of the most burdensome of the excise taxes with respect to the lower-income groups," and, since the tax did not apply to publicly-owned electric power systems, "to impose the tax on some consumers and not on others is believed discriminatory." But the House bill provides that no tax shall be levied upon any admissions to swimming pools, bathing beaches, skating rinks, and other places operated by a governmental unit. If the facilities are operated as a private enterprise the customers must pay tax. If tax on some users of electricity but not on others is discrimination, then why is it not discriminatory to impose a 20 percent tax on admissions of young boys and girls to private pools and rinks when no tax will apply if the facility is publicly-owned?

The unfair imposition upon the youth of the country is amplified by the proposed exemption of fishing trips from transportation tax. Now practically all sports personally engaged in will be exempt from excise tax, including fishing, bowling, golf, tennis, and horseback-riding. But no relief is granted to children who might find it more convenient to swim or roller skate at a private pool or rink.

SHOULD SEWING MACHINES BE SUBJECT TO A 25-PERCENT EXCISE TAX?—AN ANALYSIS BY THE FREE SEWING MACHINE CO.

(By Lewis Emery, treasurer, Free Sewing Machine Co.)

We assume the primary reasons for such a tax at this time are—
1. To curb inflation by curbing demand.
2. To increase Government revenue.

These are reasons in the public interest. This analysis is in terms of how such a tax would affect the public interest.

Our conclusion is that it would not be in the public interest to impose a 25-percent excise tax. In fact, we believe the opposite to be true.

In this analysis we are illustrating specifically why we feel a 25-percent excise tax on sewing machines now will actually operate to the detriment of the defense program and be contrary to public interest.

In the first place, a sewing machine is a production tool. Sewing machines are not home appliances as such.

This is not the case with the woman using the ordinary home appliance as a labor-saving device. A woman using a sewing machine actually creates, fabricates, produces, maintains, and repairs basic necessities of life.

In 1949 the United States garment industry manufactured 728,000,000 items of women's and children's apparel. In the same year women at home made 800,000,000 items of similar apparel. Three out of every ten garments were home-sewn and this does not take into account the many more millions of garments which were repaired in the home and thereby kept in daily use. Every family with growing children knows what this means. We also must remember that with the likelihood of further clothing shortages, families of moderate means will more and more have to repair the clothing which they already have for themselves and their children. Furthermore, this does not take into account the many millions of other items which each year are home-sewn—draperies, furniture coverings, curtains, towels, bedspreads, sheets, and many other necessities.

As a production tool that is used by millions of women to supply a basic need in our economy, the sewing machine conserves manpower, curbs inflation, and is indispensable to millions of users.

Our second point is the conservation of manpower. An average of two man-hours is required to produce an article of clothing by the garment industry. This means that the sewing machine is currently conserving our industrial manpower at an estimated rate of 450,000,000 man-hours per year. This, from new garments alone, established the sewing machine as a production tool of tremendous value to our defense program. Furthermore, a woman with a sewing machine needs fewer new clothes. She can repair, alter, and remodel, and in doing so she conserves materials as well as needed skilled manpower.

During our defense economy women should be encouraged to own sewing machines, because with them they can produce needed goods for the Nation. If they are discouraged by excise tax, some professional workers will have to fill this need. Every million garment made or repaired at home means 1½ million man-hours saved to produce other civilian or military goods.

In addition to the first point that the sewing machine is a production tool and the second point that it conserves manpower, our third point is that as a production tool it also helps to curb inflation. I should like to explain why, in very simple terms. The principal reason why a woman makes clothing at home is because it is cheaper than buying ready-to-wear clothing. During the past 10 years prices of ready-to-wear clothing have more than doubled. An excise tax on sewing machines which will compel more women to buy ready-to-wear clothing (many of whom cannot afford to do so) will serve to force the price of ready-to-wear clothing even higher. A more direct form of inflation cannot be imagined.

Now for point 4. The principal market for sewing machines is among families with moderate or low incomes. A family with an income of $5,000 per year has a much greater need for a sewing machine than the $10,000 a year family. Almost 80 percent of the families in America are in or below the $5,000 per year income bracket. A substantial portion of the annual income of these families must be budgeted for clothing and other home necessities, which may be made on a sewing machine. These families must sew at home in order to afford proper clothing. To them the sewing machine is a major purchase. A manufacturer's excise tax of 25 percent would mean an increase of approximately $45 in the retail price of a sewing machine. Since this is a substantial increase it would place the purchase of a sewing machine beyond the reach of those who need it most.

Therefore, a tax upon sewing machines would not be a tax based upon the ability to pay. It would be a tax burden which falls most heavily on those least able to pay, although they are the people who have the greatest need for a sewing machine.

To emphasize this very important point we would like to remind the committee that there are some 41 million family units in America today: 15 million of these family units were started in the last 10 years. One out of every three family units was started in the last 10 years. Obviously, these family units include a large percentage of young children whose clothes constantly need repair and replacement, and these young families are the ones which can least afford to pay the increased cost of such a tax.

To come to point No. 5, we believe the sewing machine is indispensable to millions of people. As we have already indicated, over 50 million women sew at home. Over 3 million youngsters are now learning to sew in schools and classes throughout the country. Close to 1 million 4-H Club girls are completing hundreds of thousands of sewing projects each year. Large numbers of sewing machines in the hands of schools, churches, Red Cross, and other charitable institutions are needed for clothing of needy people and for our own defense needs.

In summation, because—

1. The sewing machine is a production tool;
2. The sewing machine conserves manpower;
3. The sewing machine curbs inflation;
4. The sewing machine is most needed by those least able to pay the tax;
5. The sewing machine is indispensable to millions of people:

Therefore, we urge your consideration in eliminating home sewing machines from the classification of products subject to the proposed excise tax. We are convinced that such a tax on sewing machines would be contrary to the public interest and the defense program of the Nation.

Senator BYRD. The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:55 a. m., the committee recessed to reconvene at 10 a. m Friday, August 3, 1951.)

REVENUE ACT OF 1951

FRIDAY, AUGUST 3, 1951

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

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry F. Byrd presiding.

Present: Senators Byrd, Hoey, Kerr, Millikin, and Martin.

Also present: Senator Henry C. Dworshak, of Idaho; Elizabeth B. Springer, chief clerk; Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

Senator BYRD. The committee will come to order.

Our first witness is James V. Carmichael.

STATEMENT OF JAMES V. CARMICHAEL, PRESIDENT, SCRIPTO, INC.

Mr. CARMICHAEL. Mr. Chairman, my name is James V. Carmichael. I am president of Scripto, Inc., of Atlanta, Ga., manufacturer of mechanical pencils, fountain pens, and ball pens.

I am appearing on behalf of the National Fountain Pen and Mechanical Pencil Manufacturers Association.

May I proceed, Mr. Chairman?

Senator BYRD. Yes.

Mr. CARMICHAEL. Mr. Chairman and gentlemen of the committee, I just want to express to you my gratitude for permitting me to appear today. I know how heavily pressed you are for time and what a chore it is to listen to all of us—the people who are protesting every tax that comes along.

I want to say at the outset, though, that this is the first time our association has ever appeared before either the House or Senate Finance Committees to protest a tax.

It is the policy of our association to go along with all taxes which are general and which are thought necessary by the Congress.

The only reason that we appear in this instance is the fact that we feel very sincerely that this tax singles us out and is discriminatory and is unfair and unjust.

Senator MILLIKIN. May I make an observation?

Mr. CARMICHAEL. Yes, sir.

Senator MILLIKIN. I think that it is very healthy for this country that people are "hollering" about taxes. I think that is the only thing that will save this country, and that is for people to "holler" about taxes and it certainly is not offensive to me to see any group of our citizens who do not want to go along with the tax.

Mr. CARMICHAEL. Thank you, sir.

Senator MILLIKIN. It is quite natural that they do not want to go along with taxes that hit them especially.

Mr. CARMICHAEL. Thank you, sir.

I appreciate that and I believe that we have reached almost the limit of our ability——

Senator MILLIKIN. Whenever we reach the point where we go along without protesting what we think are unfair taxes put on us, we are done—we are dead ducks.

Mr. CARMICHAEL. I think you are right. I appreciate your remarks.

The first point I want to make to this committee is that mechanical pencils, fountain pens, and ball pens are not luxuries, but are an essential part of our dailly life in this modern age.

It is hard to conceive of any sort of business being transacted in this day and age without the use of writing instruments.

They are necessary to institute the designs on the drafting boards of our industries, to handle the work orders. They are necessary in all processes of education, from the grammar schools through our colleges, and they are essential to the morale of our people.

The essentiality of our industry and of our product has been recognized by the National Production Authority and our industry has been so classified as an essential industry and is allocated material for the production of its products on that basis.

As a matter of fact, the mechanical writing instrument of today is the tool of trade of millions of white-collared workers in America.

They sit at their desks or they work at their jobs, and almost constantly they use a fountain pen, a ball pen, or a mechanical pencil, and to impose a tax such as this proposed here upon these mechanical writing instruments is to tax a tool of trade of those millions of white-collared workers, just as much as if you were taxing the saw that the carpenter uses or the trowel that a mason uses or the tools that a mechanic uses, because they are the tools with which they make their living, and to impose this tax is, in fact, to tax a tool of trade of millions of white-collared workers of America.

Probably the largest class of users of mechanical writing pens and pencils are the school children of this Nation. There are 32,000,000 school children in this Nation and from the time they get out of their primary grades they are required to use fountain pens or ball pens and mechanical pencils.

Senator MILLIKIN. Just think of all the people in Government employment who use fountain pens. It is just a case of taxing the Government.

Mr. CARMICHAEL. Exactly sir.

Senator MILLIKIN. The Government taxing itself.

Mr. CARMICHAEL. And if you take the fountain pens and pencils away from the Government it would stop tomorrow.

Senator MILLIKIN. That would be a wonderful thing. [Laughter.] You have got something there. I had not thought of that.

Mr. CARMICHAEL. The best way to end all bureaucracy, Senator, is maybe to take the writing instruments away from the Government. [Laughter.]

Senator BYRD. Especially the red ink. [Laughter.]

Mr. CARMICHAEL. Yes, the red ink. Back in the days when I was in school, a child had an ink bottle and a staff that he used for his work, but today that is impossible. They move from class to class and without the fountain pen the boy could not possibly get his work done, and certainly, as I say, business could not be carried on.

Of these 32,000,000 children, 17,000,000 of them have families who have a $3,000 or less income, and to impose a 20-percent tax on the instruments which these children have to use in their schools would certainly be placing it on the group least able to pay it.

And I think one of the most important factors of the mechanical writing instrument is the morale factor to our servicemen.

We have got over 3,000,000 in the service, and there is no single factor that does as much for their morale as to be able to write home to mama and papa and to receive a letter from mama and papa and without the mechanical writing instrument and the fountain pen, such correspondence would be impossible, and to say you are going to tax that soldier, with his modest income, 20 percent for the instrument with which he comes in contact with the home folks, to me is unthinkable.

Now, this tax was not even proposed by the Secretary of the Treasury—and he usually thinks of most things that can be taxed—but this tax was not even proposed to the House committee by the Treasury Department. It was not even proposed by a member of the House Ways and Means Committee.

The first our industry knew about it was on May 14 when we read a press release that it had been included by the House Ways and Means Committee and was thought up by a staff member after all public hearings had been closed, and the industry had no chance to appear to voice its protest.

It is an ill-conceived, hastily thought up tax, and was based on the fact that it was an extension of the jewelry tax, and was so announced in the press by the House Ways and Means Committee—that the jewelry tax—that is, the tax on writing instruments which have gold upon them or precious metals—would be extended to cover all fountain pens, mechanical pencils, and ball pens.

Now, our industry has no objection to the 20 percent tax on fountain pens, ball pens, and mechanical pencils which have gold on them that is made up for ornamental purposes. And the person who wants his dressed up with gold, let him pay a tax on it, if it is necessary for the support of this Government.

Senator BYRD. How much revenue will this bring in?

Mr. CARMICHAEL. The most liberal estimate from the writing industry is $26,000,000 and that is, as I say, liberal. At least half of that would be paid by the school children of America, and then another large segment of it would be paid by the servicemen, and the rest of it would be paid by the white-collared workers of America, the people who use these things to make their daily bread.

We want no special favors; we are not asking you to give us any special exemptions, but we feel this tax is discriminatory in that it singles us out. We are not a luxury; we are strictly a utilitarian product and, as such, should not be taxed until the time comes when this country is willing to say that we are going to place a general sales tax on everything that is sold.

If that becomes necessary for the support of our Government, or for the defense of our country, we will not appear to protest it, but we do not feel that we should be singled out at a time—by this, and classified as a luxury—when there is absolutely nothing but essentiality surrounding our entire product.

I will be glad to try to answer any questions that any member of the committee might have.

As I say, it will produce probably $26,000,000.

I would like to point out that it is levied at the manufacturers' level, and we sell on a varied discount structure, and what is going to happen is that a profit is going to be added, and it is going to be added up and going to be about a 40 percent retail tax when it gets to the retail trade, and the consumer is going to pay more without any benefit to the Government.

Senator BYRD. Thank you very much.

Mr. CARMICHAEL. Thank you.

(The prepared statement of the Fountain Pen and Mechanical Pencil Manufacturers Association and a letter from Senator Hickenlooper to the chairman follow:)

MECHANICAL PENCILS, FOUNTAIN PENS, AND BALL POINT PENS

Proposed excise tax, section 486 of H. R. 4473:

"(a) IMPOSITION OF TAX.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equal to 20 per centum of the price for which so sold: Mechanical pencils, fountain pens, and ball point pens.

"(b) EXEMPTION IF ARTICLE TAXABLE AS JEWELRY.—No tax shall be imposed under this section on any article under section 2400 (relating to jewelry tax)."

This brief is submitted on behalf of the Fountain Pen and Mechanical Pencil Manufacturers Association, Inc. That association is composed of some 83 manufacturers of fountain pens, ball point pens, and mechanical pencils. The membership represents approximately 90 percent of the total production of these writing instruments. Its headquarters are at the Albee Building, Washington, D. C.

ESSENTIALITY

Writing instruments are not a luxury. They rank among the most important necessities of everyday living. There is not one single vital process which can be carried through from beginning to end without the use of some kind of writing instrument. Freight does not move without a written order or consignment. Production stops if the administrative and clerical staffs have nothing with which to write. Conceive of military operations without written orders or communications. The paper work which is involved in every operation—civilian or military—is basic and essential. Without writing instruments, every operation in our present-day economy would come to an abrupt end. Production would stop. Mass transportation would cease. Communication would be confined to the spoken word, trade and commerce would disappear, and even education would be virtually halted.

Mechanical writing instruments are the most efficient, portable, all-purpose writing instruments ever conceived. They are durable—their utility is measured in years, not in days or weeks. They are efficient. A fountain pen, whether conventional or ball type, carries its own reservoir of ink. A mechanical pencil carries a lasting supply of lead. No ink wells or pencil sharpeners are needed for mechanical writing instruments. They save time. Anyone can write legibly, smoothly, and quickly under almost any conditions, and any place, with a mechanical writing instrument.

Thus, an unadorned mechanical writing instrument is not a luxury item. It isn't a toy or a novelty. It is a vital, utilitarian instrument filling a demand for which there is no substitute. The proposed excise tax is on a necessity, not a luxury. It is going to hit all classes of people from educators and students to clerks, soldiers, and executives.

THE PROPER TEST: FUNCTIONALITY VERSUS ORNAMENTATION

For many years the Congress, the Treasury Department, and the industry have recognized the fairness of a taxability test based on the presence or absence of ornamentation on fountain pens, ball-point pens, and mechanical pencils.

We must bear in mind that a functional part can be pleasing to the eye without being ornamented or adorned in the sense of a use for purely decorative purposes. If ornamentation is not needed for functional or utilitarian purposes, it has been and can continue to be taxed on the retail sales price.

If the part is actually utilitarian in character, even though pleasing to the eye, there should be no excise tax of any kind on it at any level unless and until all articles of lesser essentiality are taxed at the same or a higher rate.

BACKGROUND

The background out of which this proposal arose is significant. It shows that the tax was not a considered move. It was conceived hurriedly without consultation or hearing. The Secretary of the Treasury did not recommend or even suggest such a tax. (See pp. 10 and 20, hearings, Ways and Means Committee, pt. 1, 1951).

We have been informed by members of the House Committee that this suggestion to tax all fountain pens, ball-point pens, and mechanical pencils originated with a staff member after the hearings before the committee had been closed.

It was adopted by the House committee without giving the industry a hearing or an opportunity to be heard either orally or by written brief. The industry first learned of this proposal on May 14, 1951, from our daily newspapers. The release stated that the House Ways and Means Committee voted to make no change in the rate of tax on jewelry, but that the jewelry classification would be extended to cover fountain pens, ball-point pens, and all mechanical pencils. By this extended coverage the committee estimated $36 million additional revenue would be forthcoming. Thus it is proposed to classify fountain pens, ball-point pens, and mechanical pencils as jewelry items and tax them as such. It is not necessary to dwell on the weakness of this position. Jewelry is certainly a luxury. Writing instruments just as certainly are not.

EFFECT ON STUDENTS

Perhaps the largest group of daily users of mechanical writing instruments is comprised of the students in the schools and colleges of the country. There are more than 32 million such students. A writing instrument of some kind is so essential to the educational process that without it there could be no such thing as the kind of education we know today. As soon as the child emerges from the first grades to the departmental system, it is virtually compulsory for him to have a fountain pen because he must carry all of his equipment with him. Ordinary pen and ink, such as he may have used when he did all of his work at one desk, become impractical. Thus the great majority of all students beyond the early grades must have mechanical writing instruments as an absolute necessity. Any excise tax, such as that proposed, would mean an additional cost to all of these students.

Many of these students come from homes whose incomes are exceedingly moderate. According to the bulletin of the Federal Reserve Board of August 1950 and based on 46 million families, the incomes of American families are as follows:

	Percent		Percent
$1,000 and under	14	$4,000–$5,000	11
$1,000–$2,000	10	$5,000–$7,000	11
$2,000–$3,000	21	$7,500–$10,000	2
$3,000–$4,000	19	$10,000 and over	3

Families whose income is $3,000 or less constitute 54 percent of the total. Applying this percentage to the total of school and college students we find that approximately 17,280,000 of them come from families which, in these days of high prices, are existing on a marginal level. Any addition, however slight, to the educational burden of such families would work an undue hardship.

Believing the educational aspect of this subject to be so important and so fundamental, the industry has reviewed available statistical surveys indicating the extent of use by students of mechanical writing instruments. These surveys have been made by wholly independent organizations, they were conducted solely for the purpose of ascertaining facts. Here is what they show.

1. Survey conducted by the magazine Varsity in 1947:
   (a) 98.5 percent of those contacted own a fountain pen.
   (b) 12 years is the average age of those receiving their first fountain pen.
2. Survey conducted by the magazine Seventeen in 1948:
   (a) 98.0 percent contacted by the survey own fountain pens.
   (b) 92.0 percent have owned mechanical pencils.
   (c) 10 years is the average age when first fountain pen was received.
   (d) 9 years is the average age when first mechanical pencil was received.

These surveys contacted teen-age boys (Varsity) and girls (Seventeen). The results show an almost universal use of fountain pens and mechanical pencils. The students so covered are in the secondary school group—junior high school and senior high school. Classes are large and in the modern system the student moves about from room to room to attend classes. It is impractical to carry ink bottles or to sharpen pencils while moving from room to room. Certainly everyone knows that the ink supply in a good fountain pen will last for days; and that the leads contained in a mechanical pencil will last for months as will the ink supply in a ball-point pen.

At the college and university level the essentiality of mechanical writing instruments is accentuated. Writing speed and legibility are necessary in higher education. The mechanical writing instrument best serves such needs. The students realize it as shown by the results of the above surveys.

It seems probable that this educational aspect of the proposed tax was not considered by the House committee. The levying of an excise tax on the "tools of education" seems clearly unwarranted.

EFFECT ON MILITARY PERSONNEL

Soldiers, sailors, and other national defense personnel and their families constitute another large group who would be adversely affected by a tax on mechanical writing instruments. During war and preparation for war, such as we are now experiencing, there is a vast separation of people from their normal locations, either to join the armed services or to take occupations in some military establishment or other form of war work. Such family separations bring about a tremendous increase in personal correspondence. The maintenance of such correspondence is a highly important factor. Prompt receipt and frequency of letters to and from service personnel was recognized as a preeminent morale factor during World War II. At one juncture, an urgent message came from the high command in the Pacific theater which said in effect: "Send us food first and send us mail second." During World War II the Army Chaplain Corps intervened against too great a curtailment of fountain-pen production.

In consideration of this morale factor, the major pen companies have announced free pen service for all men in the service overseas for the duration of the national emergency. These companies can exhibit many letters from servicemen in Korea and Europe who have returned their writing instruments for repair. The essence of their messages is to speed the writing instrument back to them because they cannot be without it for any length of time.

There are now more than 3,000,000 men under arms, a great many more in veterans' hospitals, and more and more troops leaving this country to serve abroad. The proposed tax on these writing instruments would comprise a penalty on one of the prime factors of morale in the Armed Forces. Military personnel, regardless of their economic or social status in civilian life, while in the Armed Forces are certainly not to be classed among those best able to bear additional taxes. Their modest incomes are not suited to additional levies. These men and their families who are left behind are making the greatest sacrifice in the interests of national defense of any group of citizens; any additional burden should not be imposed upon them.

EFFECT ON INDUSTRIAL AND PROFESSIONAL WORKERS

As already pointed out, mechanical writing instruments are necessary throughout all production and commercial processes: clerical, drafting, designing, production planning, inspection, office, shipping, bookkeeping, timekeeping, payrolls, production control, engineering, supervision, storage, sales, and management. The mechanical writing instrument is an essential tool that must be used by almost every worker in industry, trade, commerce, or the professions. For all those who perform their work, for the most part, away from a desk, a fountain pen, mechanical pencil, or a ball-point pen is necessary, as one cannot very well carry around an ordinary pen and a bottle of ink. And even for those who work at a desk, a mechanical writing instrument is oftentimes greatly preferred and more efficient. To tax writing instruments used as tools by the millions of workers, would be no more logical or just than to tax a hammer or saw used by a carpenter, a wrench used by a plumber, a clinical thermometer used by a nurse, or the contents of a mechanic's tool box. These millions of workers, for the most part, earn modest incomes and the proposed tax would be one imposed on one of the essential tools by which they earn their living.

PROPOSED TAX WILL BE CONCEALED AND COLLECTED DOUBLE FROM THE CONSUMER WITH GOVERNMENT GETTING ONLY ONE-HALF

Any excise tax on functional as distinguished from adorned or ornamental fountain pens, ball-point pens, or mechanical pencils, which ornamented items are now taxed at 20 percent under the jewelry classification, will be discriminatory unless there is a general consumption tax on all articles regardless of essentiality. This will be true regardless of the level at which the tax is proposed and regardless of the amount of rate of the tax.

The proposed tax has the further vice of being susceptible of concealment—which means it will be concealed.

Most important of all there is nothing to prevent a profit being collected at each stage of the distribution of such writing instruments to the ultimate consumer. This means a double tax on the consumer with the Government getting half.

CONCLUSION

The millions of students, workers, and members of the Armed Forces and their families would be the ones called upon to contribute to the proposed tax on mechanical writing instruments. The fact that the tax is a "hidden" tax (being imposed on the sale by the manufacturer rather than on the sale by the retailer) makes it no less unfair and unjust. It is imposed on a utility item that is essential to the conduct of everyday business and in every phase of modern life. As a subject of taxation these writing instruments—tools in the hands of most users—do not qualify under the principles upon which the excise taxes were imposed in the acts of 1941 and 1943. Those taxes were intended to place a premium on luxuries, to discourage the acquisition of articles and things not essential in a state of war, and to be levied on those best able to bear the burden. The present tax on those mechanical writing instruments ornamented with gold or other precious metals is a tax of that character. It can be continued. It could even be increased, as an emergency tax, although any increase is bound to produce but little additional revenue. But the proposed tax on all other fountain pens, ball point pens and mechanical pencils is a tax on a utilitarian item that in most cases is a necessity; it is a tax on an article the acquisition and use of which should be encouraged rather than discouraged during a war emergency with the many family separations which inevitably occur; and it will be borne by the millions of students, workers and members of the armed services most of whom are least able to bear additional burdens and against whom the imposition of additional burdens is least warranted.

UNITED STATES SENATE,
COMMITTEE ON FOREIGN RELATIONS,
August 3, 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: It is my understanding that Mr. Frank L. King, executive secretary of the Fountain Pen and Mechanical Pencil Manufacturers Association, Inc., will appear before the Senate Finance Committee to present the views of this industry when excise tax witnesses are scheduled in hearings on H. R. 4473.

The W. A. Sheaffer Pen Co. of Fort Madison, Iowa, which is one of the largest of its kind in the country, is very much concerned with the excise tax on fountain pens, ball-point pens, and mechanical pencils. Representatives of this company have called upon me. Under the present law, ornamental writing instruments are subject to an excise tax of 20 percent of the retail price.

The W. A. Sheaffer Pen Co. does not seek a reduction in that excise tax for ornamental instruments, in fact, they would not seriously object if the rate were increased. I make this statement to indicate that Sheaffer is not attempting to avoid taxes but that they believe that ornamental founain pens have been for many years the proper subject for imposition of a special excise tax; however, they are concerned with the question of an excise tax on functional writing instruments. These may be looked upon in the same category as working tools for business and professional people and for college students and school children.

It is my understanding that in the House Ways and Means Committee there were not hearings on the question of imposition of excise taxes on unornamental writing instruments and that the Treasury Department did not propose such tax. I am advised also that the vote in the committee on this item was close and, therefore, am glad to know that the Senate Finance Committee expects to give the pen manufacturers an opportunity to be heard and I hope that in its final decision the committee may give full consideration to the elimination of the tax on unornamental writing instruments. I understand that the amount of revenue which would be raised is very small.

Yours sincerely,

B. B. HICKENLOOPER.

Senator BYRD. This will be included for insertion into the record from Senator McCarran.

(The letter referred to follows:)

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
July 31, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: It has come to my attention that certain provisions of the Revenue Act of 1951, H. R. 4473, are directly prejudicial to the continued well-being of the economy and government of the State of Nevada. I am certain that this cannot be the intention of the Congress or of your Finance Committee.

Section 403, amending section 3267 (a) by increasing the tax on coin-operated gaming devices to $250 per year per machine, will put many individuals out of business in Nevada. This is the third such increase in this tax and it cannot be borne by those engaged in legalized gambling, unless there is some equitable adjustment, such as I intend to propose by way of an amendment, a copy of which is attached hereto.

If this proposed increase in taxes on slot machines becomes effective, the figures in my possession show that over one-half of the State's licensees will not renew their licenses. The revenue loss to the State of Nevada for this item alone will be tremendous, the resulting unemployment will be serious, and the dislocations to the economy of the State will be paralyzing.

The effect on our few, scattered, small cities and towns will be even more drastic. The actual loss in direct taxes to local governments in Nevada will amount to one-half million dollars compared to an estimated Federal gain of only $57,000.

The direct revenues received from gaming represent one of the most important sources of revenue of State, county, and local governments in Nevada. For the fiscal year ending June 30, 1950, a study by the Nevada Tax Commission discloses the following:

1. Of State revenues available for legislative appropriation, 28.03 percent were from direct gaming taxes.
2. At the county level, gaming taxes now represent the second largest source of county revenue.
3. At the city and municipal government level, gambling revenues loom large, making up 23.93 percent of total revenue, the largest factor other than the general property tax which accounts for 43 percent of the total. Much of this property tax is also borne by gambling properties.

It should be kept in mind that the above percentages represent direct gaming taxes on the gaming itself. Our gaming laws are strictly enforced and observed in Nevada. Records are required, and the history of gaming in Nevada has been one of cooperation and fairness rather than one of corruption. No district attorney in Nevada has had an opportunity to publicize himself by uncovering illicit relationships between gamblers and State or local officials.

If, as may really be the case, the proposed tax is intended to suppress all gambling, whether legal or illegal, throughout the United States, it goes far beyond the recommendations of the Kefauver committee which is the most quoted source in the country on this subject. Its recommendations (see Recommendations VI, VII, IX, of the Third Interim Report) are directed at the illegal operator, requiring him to furnish annual net worth statements, to keep detailed records, and to deny him deductions for tax purposes. That committee apparently asumes that legal gambling, locally regulated and operating in the open, is to be treated as any other legitimate enterprise. Nevada has long operated on this same principle.

I do not know just how many countries or localities in the United States levy a tax on gaming devices. It is my belief that there are very few, outside of Nevada, and that this tax will work a greater hardship on our localities than on any other.

With this in mind, I intend to offer an amendment to the proposal as it now appears in the tax bill. If the licensed taxpayers are permitted to deduct the amount of similar license tax paid to State and local governments, from the $250 license tax per machine to be paid to the Federal Government, the total burden would be equalized over the United States, as all slot machines would then carry an equal tax burden of $250.

Insofar as the State of Nevada is concerned, this deductibility would result in increased revenue to the Federal Government since licensees would not be forced out of business through double taxation on a licensing basis. It goes without saying that the Federal Government would also benefit by the continued payment of Federal income tax and income derived from this industry. Furthermore this procedure should also result in more adequate law enforcement in other jurisdictions which license coin-operated gaming devices.

With this in mind I submit, for the record, a copy of the amendment as I propose it. I would appreciate your committee giving it the utmost consideration, keeping in mind the effect on Nevada of any penalizing tax of the nature contemplated here.

My kindest personal regards and all good wishes to you.

Sincerely,

PAT MCCARRAN.

AMENDMENT TO H. R. 4473

On page 122, strike out all in lines 15 to 17, inclusive, and insert in lieu thereof the following:

"(a) Section 3267 (a) (tax on coin-operated gaming devices) is hereby amended by striking out '$150' wherever appearing therein and inserting in lieu thereof '$250.'

"(b) Such section is hereby further amended by redesignating subsection (d) thereof as subsection (e) thereof, and by inserting, immediately after subsection (c) thereof, the following new subsection:

"'(d) CREDIT AGAINST TAX FOR CERTAIN STATE AND LOCAL LICENSE FEES.—In the case of every person liable for the payment of any tax under this section for any year upon any device or devices defined in clause (2) of subsection (b), there shall be allowed a credit against such tax in an amount equal to the amount of any license tax or taxes paid by such person for such year to any State or any political subdivision thereof for the use or operation of such device or devices, except that the amount of such credit shall not exceed the amount of such State or local taxes computed at the rate or rates prescribed by law or regulation in effect on June 30, 1951.'"

Senator BYRD. Mr. McMains.

STATEMENT OF THOMAS F. McMAINS, VICE PRESIDENT AND ASSISTANT TO THE PRESIDENT, WESTERN UNION TELEGRAPH CO.

Mr. McMAINS. Mr. Chairman, I have a statement which I would like to read into the record of the proceedings.

My name is Thomas F. McMains. I am vice president and assistant to the president of the Western Union Telegraph Co.

I am glad to have this opportunity to supplement the testimony presented by my company before your committee on July 6, 1950, which described the critical position of the Nation's domestic telegraph industry, primarily due to the postwar application of a 25-percent excise tax on telegrams.

Recent developments which have seriously affected the operations of this vital industry, make relief from the 25-percent telegram tax more urgently necessary than ever before, in the national interest. While, in accordance with the committee's directive, this presentation will be brief, we respectfully request that, in addition, renewed consideration be given in your current deliberations to the facts which have been submitted to your committee at earlier public hearings.

We are, of course, fully aware of the exhaustive study your committee is giving to the development of a new tax program to meet the requirements of the country's defense and mobilization program.

It is generally assumed that the requirements of national defense are of such a character that the revenue needs of the Federal Government will remain at high levels for a long time to come.

Therefore, we urge that the committee in dealing with the unique excise-tax problem confronting Western Union give primary consideration to the long-term consequences of the tax rates made applicable to telegrams, in the light of the vital importance such a determination will hold for the future of the national telegraph system.

The immediate cause of this urgent appeal to your committee is the recent granting of wage increases aggregating $16,500,000 annually to the company's employees, to meet higher living costs, and to avert a Nation-wide strike which would have seriously impeded the national defense and disrupted the public's record communications in a time of national emergency.

The company had no alternative in this situation but to apply to the Federal Communications Commission for telegraph rate increases. Compelling evidence of the urgency of the rate application is the fact that this added wage burden would again thrust the domestic operations of Western Union into a deficit position.

I might underline the gravity of the immediate situation by adding that, as a result of wage increases, our operations for the month of July resulted in a substantial deficit. Since only part of the wage increases became effective July 1, with the remainder scheduled to go into effect on September 1, it is obvious that the impact on the company's wage bill in future months will be greater even than in July.

It should be emphasized that the rate increases applied for by the company, together with comparable increases for intrastate traffic which must be authorized by 45 State regulatory commissions will, if granted in their entirety, fall short by about $4,000,000 annually of meeting the added cost of the wage increases already agreed to by the company. This additional burden will thus fall with heavy impact upon the telegraph company, which has all too recently emerged from an extended period of deficit operations.

Since competitive rates for other rapid communications services are factors affecting the extent to which the telegraph rate increases can be sought, the existing excise tax discrimination against the telegram in favor of the telephone has an important bearing on this situation.

Telegrams, Western Union's major source of revenue, now bear a 25-percent excise tax, in contrast with a 15-percent rate applied to the telephone companies' major source of revenue—local telephone service. The effect of this existing competitive discrimination would be even more sharply accentuated by the continued imposition of a 25-percent tax on telegrams, at the increased rates necessary to meet Western Union's increased wage costs.

While the telephone companies have met their rising costs by increasing their local telephone rates, the impact on telephone users has been substantially less than in the case of telegraph users, because of the lower telephone excise tax rate. In the long-distance field, telephone rates have been reduced, the last reduction being effective in 1946.

In this connection it should be pointed out that at House committee hearings in 1947, and in 1950, a representative of the telephone system, while advocating the repeal of all communications taxes, expressed the preference, if complete elimination were not possible, for primary relief in the local field.

In discusing with the House committee in 1947 the question of selective treatment for the telegraph business in the event an over-all elimination of excise taxes was not possible, the representative of the telephone company frankly recognized the serious problem confronting Western Union as warranting special consideration.

It should be noted, incidentally, that the approval of the telegraph rate increases applied for by the company would automatically increase the tax yield to the Treasury, and impose, in addition to 10-percent higher telegraph rates, a still higher tax burden on telegraph users already required to pay a superluxury rate.

You will recall that H. R. 8920 was passed by the House of Representatives of the Eighty-first Congress and was pending before the Senate when the international crisis required abandonment of the adjustments which were included therein. Even though the House did not extend to Western Union the full relief requested, it gave consideration to the unique features existing in Western Union's case and reduced the telegram tax to 10 percent.

With regard to H. R. 4473 currently under consideration by your committee, providing for a reduction in the telegraph tax from 25 to 20 percent. I would call to your attention the following quotation from the report of the Committee on Ways and Means which accompanied this measure:

* * * Since World War II telegraph service in the United States generally has been carried on at a deficit. So far this year the service has been operated at a profit but wage negotiations now under consideration may again place telegraph service in a deficit position. By reducing this tax on telegraph service your committee anticipates that it will be possible to decrease the amount paid for telegraph messages, and that as a result the volume of business done will be increased and the profit position of the industry improved. Telegraph service not only is essential to the civilian economy but also is essential to national security.

At the time the report of the House Committee on Ways and Means was prepared, Western Union had offered to grant its employees wage increases aggregating $12,500,000 annually, in accordance with the national wage formula. It proved necessary, however, in order to avert a Nation-wide strike, to increase this offer by $4,000,000 annually, thus providing far greater reason for the concern expressed in the report about the impact of these wage negotiations on the telegraph industry, and it is submitted, making crucially necessary a greater degree of relief than is provided in the House measure.

Western Union, since World War II, has mechanized and increased its facilities to the extent that it can accommodate the requirements of mobilization and at the same time meet civilian and business demands at higher levels. The carrying out of a Nation-wide mechanization and improvement program, which has doubled the company's World War II plant capacity, was based on the firm conviction that the 25-percent telegram tax, imposed during the war at super-luxury levels to discourage the use of the telegraph and keep the wires open for urgent war traffic, would be repealed at the end of the war. Instead, the continuance of this volume-destroying tax, and the absence of relief from the competitive tax inequity it created, have hindered Western Union's efforts to attract increased telegraph business, and we have now been confronted with the necessity of increasing telegraph rates, as stated, to produce part of the added revenues required to provide cost-of-living wage increases to telegraph employees.

We respectfully urge that your consideration of Western Union's present critical situation take into account recognition of the foregoing factors.

Now, as to Western Union's current position: For the calendar year 1951, even if the full amount of the rate increases requested were made effective on September 1, the company could reasonably anticipate a net return of less than 4½ per cent on its plant investment. Under the present excess-profits tax bill the company is entitled to earn a net return of 7 per cent before the application of any Federal excess-profit tax provisions. We point this out to indicate that the estimated results for the year, even under the most favorable conditions possible, would fall far short of any semblance of a fair return.

The forecast of a net return of less than 4½ percent for the year 1951 is the most optimistic figure that could be presented since, with respect to revised intrastate rates which represent an important part of the telegraph rate increases requested, it would be impossible to make these effective as early as September 1. Even without rate hearings, some States require 60 to 90 days after filing before the rates can become effective and, where hearings are necessary the delay would be even greater.

With regard to subsequent years, since a major portion of the wage increases granted by the company became effective on July 1, with the remainder scheduled to become effective September 1, it is obvious that the full impact of these wage increases will not be felt in the calendar year 1951. In 1952 and subsequently the full impact of the wage increases will of course be felt, with additional and even more serious effect upon the company's earnings.

It is clear therefore that Western Union could not anticipate, at best, any more favorable results for 1952 and subsequently than the return of less than 4½ percent forecast for this year.

Indeed, to approach even this result would require—in addition to approval of the full amount of the rate increases requested by the company—continuance of the present emergency-induced higher level of telegraph business; retention of the present corporate tax level;

and the maintenance of operating costs at their present levels, a combination of circumstances which is highly unlikely.

It is obvious that so inadequate a rate of return—even if it were possible of achievement in the light of the uncertainties I have mentioned—would seriously jeopardize the strength and solvency of any public service company and make difficult, if not impossible, the continuing improvements in the country's vital telegraph system which are of imperative importance to the national interest.

For the reasons already cited, the gap between the amount of rate relief requested and the cost of wage increases granted by the company can be narrowed at this time only by attracting increased telegraph business through reducing the over-all cost of telegraph service to the public. To accomplish this a reduction in the excise tax on telegrams to a maximum of 10 percent or less would be required.

We have a deep sense of appreciation of the problems with which your committee is confronted in determining the manner in which the funds needed to assure our national safety and well-being can be obtained with minimum disturbance to the economy.

Insofar as the telegraph excise tax is concerned, it is submitted that the reduction in Federal revenues which would result from lowering this tax to 10 percent—a total reduction of $21,500,000 based on the full year 1950—could have no material bearing whatever on the Government's budget problem, particularly since there would be important offsets to the Treasury, as for example, through increased corporate income taxes from telegraph users. Approximately 75 percent of the domestic telegraph revenue comes from business concerns, whose telegraph excise-tax payments are deductible in the computation of corporate income taxes.

In any event, based on Treasury Department estimates for the fiscal year 1951, the entire amount of the proposed reduction represents less than one-half of 1 percent of all excise-tax collections.

The reduction would have, however, an all-important bearing on the problem of this industry, competing as it does—unlike the telephone—with the tax-free and Government-subsidized air mail, and with the selective telegraph operations of the telephone companies, which companies have for years enjoyed a substantial competitive excise-tax advantage over the telegraph company.

I should like to repeat a statement by Senator Ernest W. McFarland which was quoted in our appearance before your committee on July 6, 1950, on this same important subject:

> While few realize it, the future of our kind of life is involved in the kind of communications policies we have. All over the world, the avenues of communications are in the hands of the state. Only in the United States do we have a free, privately owned system. We want to keep it that way.

We stated at the time of this previous hearing, and it is even more timely today in the light of recent developments:

> The decision which Congress will make concerning the excise tax on domestic telegrams is not simply a policy decision regarding the small amount of tax revenue obtained from this source. The decision directly affects the fundamental question of national communications policy referred to by Senator McFarland.

We therefore believe we are acting in the national interest, as well as in the interests of more than 43,000 telegraph employees, 4,800 pensioners, and 20,000 stockholders in requesting your committee at this time to extend the equitable tax treatment which was provided for in H. R. 8920 in the Eighty-first Congress, thus providing the only presently practicable means for obtaining the additional revenue needed to offset the cost of the wage increases granted to the company's employees.

Senator MILLIKIN. What is the dividend history of Western Union in recent years?

Mr. McMAINS. We were in deficit operations for several years, up until the latter part of last year. A dividend was paid of $2 during the latter part of 1950, and so far this year we have paid 50 cents each quarter.

Senator MILLIKIN. Prior to that time for how many years had you been in a deficit position?

Mr. McMAINS. The history is spotty, going back to 1929. You had two or three of the war years in which we did pay a dividend.

Prior to the war we paid, during the latter part of the thirties, a dividend of about $2 a year, and then there were several years in which we had deficit operations and paid no dividends; and prior to 1929, for quite a number of years, we paid an $8 dividend.

Senator MILLIKIN. In previous testimony, officials of your company stated that you had a large modernization program underway.

How far along are you on that?

Mr. McMAINS. In the modernization program that has been referred to at various hearings, we have that program practically completed at the present time but, of course——

Senator MILLIKIN. How did you get the money to do that?

Mr. McMAINS. Partly through depreciation reserves, and partly through the sale of real estate as, for example, when we sold the headquarters building of Western Union and leased it back, and quite a number of our other buildings which were sold and leased back by us on lease-back arrangements, in order to raise money for the modernization program, and also for debt reduction.

Senator BYRD. Thank you very much.

Mr. McMAINS. In the light of the critical situation now confronting Western Union, I respectfully but urgently recommend extension by your committee of excise-tax relief to a degree that will impose a maximum telegram tax of no more than 10 percent.

Thank you.

Senator MILLIKIN. I should have caught it before this but exactly what are you asking for?

Mr. McMAINS. I guess I did not——

Senator MILLIKIN. The House reduced you to 20 percent.

Senator KERR. To 20, and he wants to reduce it to 10.

Senator MILLIKIN. You want us to reduce it to 10?

Mr. McMAINS. That is correct.

Senator BYRD. Mr. Louis Ruthenburg.

STATEMENT OF LOUIS RUTHENBURG, CHAIRMAN, NATIONAL COMMITTEE FOR FAIR EMERGENCY EXCISE TAXATION, ACCOMPANIED BY LEON HENDERSON, CONSULTING ECONOMIST

Mr. RUTHENBURG. Mr. Chairman and gentlemen of the committee, I am Louis Ruthenburg, of Evansville, Ind., chairman of the board of Servel, Inc., manufacturer of gas refrigerators and water heaters.

I appear before you as chairman of the National Committee for Fair Emergency Excise Taxation, a committee of more than 50 principal executives of companies directly affected by excise taxation. Attached to my statement is a letterhead of the committee which shows its membership.

The members of this committee are traditionally opposed to all Federal excises or sales taxes, whether they are imposed selectively or at the manufacturers' level, or at the retail level; in fact, last year I appeared before you in behalf of the National Committee for Repeal of Wartime Excise Taxes to seek repeal of the taxes imposed or increased during World War II. After Korea, in recognition of the realities of mobilization, our committee was reconstituted into its present form. When the present emergency is over we shall again seek the repeal of all Federal excise taxes.

Senator KERR. You do not hold the view of those then who have come before us recommending a flat tax at the manufacturers' level on all manufactured products except food?

Mr. RUTHENBURG. No, sir. As will appear in my testimony, we believe that the tax should be applied uniformly at the retail level and not at the manufacturers' level.

We are glad that the House in its wisdom rejected the Treasury proposal to pile extremely high sales taxes on a small group of commodities. They would have been harmful to the country and most unfair. We think that the House bill is good in that it did not accept those extremely high rates; we think it is bad in that it continues the discrimination that is basic to any selective approach.

If Congress concludes that substantial revenue from the field of excises is required for this emergency our committee unanimously suggests the enactment of a defense emergency tax, at the retail level, at a uniform rate, and across the board, exempting only food, medicine, rent, and certain other traditionally exempted services. This is a retail sales tax, but we suggest the name "defense emergency tax" so as to label it clearly, as one imposed for the emergency only.

If exercises are to be used in a major way during the present emergency, we believe that the present selective hodgepodge of excises—some at the manufacturers' level, and others at the retail level; at various rates; and under different conditions—should be abandoned and that they should be replaced with a system which is equitable, revenue producing, nondiscriminatory, and specially earmarked for the emergency only.

At the first moment that Congress concludes that revenue from excises is no longer required for the emergency, our committee urges that this defense-emergency tax be eliminated entirely from the Federal tax system.

Senator KERR. Suppose it got to the point where the Congress would decide that they would not put on a defense-emergency sale at the retail level, then would you favor such a tax at the manufacturers' level and on an across-the-board basis in preference to the one that we now have?

Mr. RUTHENBURG. Senator, I believe that would be a lesser evil than the present discriminatory taxes.

We believe, however, that it has weaknesses that can be clearly pointed out.

Senator KERR. Do you point some of those out in here?
Mr. RUTHENBURG. Yes, sir.
Senator KERR. Fine.
Mr. RUTHENBURG. Such a tax would produce substantial revenue, and be flexible for adjustment with changing requirements; it would retard inflation and avoid discrimination; it is administratively feasible; and it would be for the emergency only.
Here are some of these high lights as we see this proposed defense emergency tax.
First, it would produce substantial revenue at low rates.
Because of its broad base this proposed defense-emergency tax would involve a low rate. It would raise greater revenue than is contemplated by the excise proposals of the Treasury.
Senator MILLIKIN. What revenue do you estimate would be obtained
Mr. RUTHENBURG. I beg pardon?
Senator MILLIKIN. What rate do you propose, and what do you believe would be the amount of revenues?
Mr. RUTHENBURG. When we presented our case before the Ways and Means Committee, Senator, we made some very elaborate computations. They were made by our consulting economist, Mr. Henderson, who is here and can give you a considerable amount of detail.
Senator MILLIKIN. Do not give us the detail, Mr. Henderson, but roughly, what is the return and what is the rate?
Mr. HENDERSON. There was no recommended rate. We say that there is a base of about $130 billion in fiscal 1952 for consideration, and that if applied to the entire base, naturally a 5-percent rate would yield about $6,500,000,000, which is at least $2 billion more than the present excises, other than gasoline, alcohol, and tobacco.
Senator MILLIKIN. Making allowance for the exemptions?
Mr. HENDERSON. Allowance for exemptions of food, shelter, and medicine.
Senator MILLIKIN. Roughly a billion per point, making allowance for exemptions.
Mr. HENDERSON. It is more than that.
Senator MILLIKIN. How much more?
Mr. HENDERSON. Again I made a calculation at the request of Representative Curtis which appears in the hearing, in which he gave me the terms of reference. It is not a recommendation of our committee. He wanted to know, assuming all the traditional exemptions that are being considered——
Senator MILLIKIN. Yes.
Mr. HENDERSON. What it would be at 5 percent, and we say it would be something like 5 or 6 billion, other than gasoline, tobacco, and alcohol, which is at least a billion and a half more than the existing system produces.
Senator BYRD. What do you mean by shelter?
Senator KERR. Rents.
Mr. HENDERSON. All rents.
Senator BYRD. You do not mean the construction of houses would be exempt?
Mr. HENDERSON. There are a number of things that go into houses which are taxed now mainly at the manufacturing level. If you

went across the board you would catch those materials just the same as you would catch any other material.

Senator BYRD. In other words, if you constructed a house those finished products that go into a house would be taxed?

Mr. HENDERSON. That is right, and a number of them are now, just like parts going into an automobile.

Senator BYRD. You recommend then that the other excise taxes above 5 percent be reduced to this 5-percent level?

Mr. HENDERSON. That is right.

Senator BYRD. Except on tobacco——

Mr. HENDERSON. Alcohol and gasoline.

Senator BYRD. Alcohol and gasoline.

Senator KERR. I understood you to say that the base was roughly 120 billion.

Mr. HENDERSON In fiscal year 1952, on the liberal exemption basis that I worked out for Congressman Curtis in great detail, taking every category of expenditures, there would be about $111 billion and 5 percent on that——

Senator KERR. Yes.

Mr. HENDERSON. You get from that, Senator Millikin, a rough computation of about a billion per point.

Seator BYRD. How much would the reductions reduce, for instance, the automobile tax which, in this bill, is 10 percent? You would lose 5 percent on that?

Mr. HENDERSON. It would be 5 percent at retail.

Senator BYRD. Then you would have to allow, would you not, for those losses; by reducing it to 5 percent, how much would that be?

Mr. HENDERSON. Well, your present 111-billion base is approximately 8½ times the base of purchases which is taxed now.

You may remember, Senator, that Secretary Snyder said that only about 22 to 25 percent of the personal consumption expenditures are taxed now, so you get a large base and a lower rate.

Senator BYRD. I understand that. I understood you to say it was a billion dollars for every 1 percent.

Mr. HENDERSON. Yes, sir.

Senator BYRD. Then you have got to take a loss off there because you are reducing other taxes.

Mr. HENDERSON. That is right.

Senator BYRD. How much would the loss be?

Mr. HENDERSON. The taxes now, other than the three which we have mentioned, produced in 1950 about 3.5 billion.

Senator BYRD. But you have not answered my question.

Mr. HENDERSON. You would lose the 3.5 billion, and your total would be something in excess of 5, so you would have at least a billion and a half additional revenue, with a reduction of these extraordinarily high rates.

Senator MILLIKIN. May I ask one more question of Mr. Henderson?

Mr. Henderson, have you ever made a study of how much a tax at the manufacturers' level expands as it reaches its way to the ultimate consumer?

Mr. HENDERSON. Yes.

Senator MILLIKIN. Do you have a general observation on that?

Mr. HENDERSON. Yes. It is about an 80 percent increase.

Senator BYRD. Go ahead, Mr. Ruthenburg.

Mr. RUTHENBURG. Our committee's consulting economist, Leon Henderson, has made original and extensive studies as to the amount of revenue our proposal will produce at varying rates. He testified before the Ways and Means Committee——

Senator BYRD. One more question: Have you got a list of those things that would be taxed under your plan?

Mr. RUTHENBURG. I beg your pardon?

Senator BYRD. Do you have a list of the things taxed under your plan?

Mr. RUTHENBURG. Those are filed in the record before the Ways and Means Committee, Senator.

Senator BYRD. A complete list?

Mr. RUTHENBURG. Yes, sir.

He testified before the Ways and Means Committee and in response to questions from members of the committee he prepared and submitted additional data.

At the conclusion of my testimony he will be available to your committee for any questions any of you may care to ask him. His studies show that this suggested defense emergency tax will produce substantial revenue from excises, and will do it equitably.

2. It would be flexible. We are just starting the second year of this emergency. How long it will last, and what expenditures it will require, no one can foretell. The "selective" sales tax proposed by the Treasury causes great difficulty whenever more money is required.

Witness the problem of the House committee and the one which is now presented to you: Which rates, if any, should be increased?

What commodities or services, if any, should be added? And so with each increase which might be necessitated if the emergency should grow more serious, or if war should come. When the time comes for reduction of taxes as the emergency ceases, the unscrambling of the hodge-podge is just as difficult.

But if the rate is uniform, the task of adjustment is easy. The rate can be fixed at one figure this year and, if need be, increased next year, and then, if circumstances permit, decreased in a succeeding year, and finally repealed entirely.

Whenever a change is desired, up or down, all that is required is a simple change in the rate of the tax.

Senator MILLIKIN. May I ask another question, please? Have you made a study of what the total burden of taxation, Federal, State, and local would be on the lower income people if you imposed this Federal sales tax?

Mr. HENDERSON. I have not made it.

Senator MILLIKIN. I am talking about open and concealed taxes. Have you made a study of that?

Mr. HENDERSON. I have not made an independent study, but I am familiar with the whole question going back to the days when I was with the TNEC when I instituted the first study. And I have reviewed all the existing studies, and a number of the criticisms on these, so I have, what I would call, a working knowledge of the burden of taxation.

I might say that the information right now on burden is, well, to say the least, in a theoretical stage, and if you adjust your theories of how taxes are passed on, you come to a completely different idea of the incidence or the burden of taxation than is commonly accepted.

Senator MILLIKIN. That is what I am driving at, what I have been driving at through all of these hearings, and I am somewhat amazed at the fuzzy nature of the information that we have available on the pass-down of all types of taxes, and on the extent of indirect taxation. Obviously, when you are talking about imposing a general sales tax, we should have some knowledge of the total burden that results, and so far I do not believe we have a very good foundation of fact on which to act.

Mr. HENDERSON. You have got a fairly good idea—so far as the low-income groups are concerned, you know fairly well what percent of their income they spend for food, for shelter, and for medicine.

Senator MILLIKIN. Yes.

Mr. HENDERSON. If you had a 5 percent tax at retail, it would mean in the incomes below a thousand there could not be more than $300 or $350 taxed by these other than the alcohol and tobacco, which are pretty regressive in those low categories.

It would reduce it, I would say—the burden, as it is published in the Joint Committee on the Economic Report. A 5 percent across-the-board retail tax would reduce it—1 percentage point of income, at least, because there would be no tax on food, or shelter, or on medicine, and that takes up a very high proportion of the very low-income group spending.

Senator MILLIKIN. The lesser the margins that are available to the people in those lower brackets, of course, the harder the impact of a tax that is put upon those things which they do buy.

Mr. HENDERSON. That is correct.

Senator MILLIKIN. It is a burden that must be given some attention.

Mr. HENDERSON. They have an enormous burden now, as Mr. Barit pointed out, I think, before your committee; 29 percent of the cost of an automobile is taxed. There are $102 of that which is the Federal excise, and there are $99 of other excises in it so that anybody in the low-income bracket who buys an automobile has got at least $200 that he pays as excise tax alone.

Senator KERR. That would not be changed.

Mr. HENDERSON. It would be changed to the extent of the 5 percent on a $2,000 automobile which would then mean $100, you see, in total.

Senator KERR. Rather than 8 percent on a $1,500 product, $1,400, I think——

Mr. HENDERSON. It is 7 now, and recommended for 10.

Senator KERR. Is it 7 now?

Mr. HENDERSON. It is 7 now and recommended for 10.

Senator KERR. Well, the president of the Hudson Motor Co. indicated that the average wholesale price of that $2,000 car was about $1,400.

Mr. HENDERSON. That is correct.

Senator KERR. Seven percent on that is $98, and 5 percent on $2,000 is $100.

Mr. HENDERSON. Yes; but you would get lower rates on the heater, the radio, all the parts and the things that go into the other $99.

Now, that $99 that goes in there is also subject to the 80 percent increase, by pyramiding, you see, and you would get rid of the pyramiding, also.

Senator KERR. You think that there would be a material saving——

Mr. HENDERSON. On the automobile.

Senator KERR. In the amount of tax paid on the purchase of a new automobile?

Mr. HENDERSON. That is correct.

I might point out that of all the manufactured items that are taxed at the manufacturers' level, the automobile industry, because of its nature in the way it handles franchises, and selling, is the only one that has the pass-through.

Senator KERR. The what?

Mr. HENDERSON. Pass-through.

Senator KERR. Yes, sir.

Mr. HENDERSON. That is, that the tax that you pay is on the factory price other than the concealed taxes I am talking about, on all the other manufactured items; they are naturally a part of the cost and are so considered, and so you picked out the one peculiar one, and even at that I would say there would be a saving.

Senator MILLIKIN. We had a witness here, who, as I recall it, said a $2,500 income family pays $700 and some aggregate taxes of all kinds, of which he pegged $300 and some as labeled taxes, and $400 and some as concealed taxes.

Well, the burden is the same, whether it is labeled or concealed, and when you take seven-hundred-and-some-odd dollars out of a $2,500 income family for taxes, considering the margins on which it lives, the small, narrowness of the margins, if there are any margins on which it has to work, you are imposing quite a burden, and I had been hoping that we would sometime during this hearing get some rather reliable facts that wuold cover that whole area.

Mr. HENDERSON. If you would want to ask me at the conclusion of Mr. Ruthenburg's testimony further on this burden, I would give you the benefit of the work I have done for this committee for pretty nearly 2 years.

Senator BYRD. Let me ask you this question: Do you exclude the sales to the Government in the computation of revenue?

Mr. HENDERSON. The sales to the Government are handled in two ways: Some of them are billed without the tax and some the Government pays the tax now.

Senator BYRD. What do you do? You figure so much on a gross-income basis of the sales—on the base. You must then include in the revenue the sales to the Government which, of course, will not be collected.

Mr. HENDERSON. That is correct, but they are now on——

Senator BYRD. Well, your estimate is probably too high.

Mr. HENDERSON. Well, the estimate of net, Senator, receipts on Federal income taxes, is grossly inflated right now because of the fact that the Federal Government does pay the excise tax practically on everything.

Senator BYRD. But that is just taking money out of one pocket and putting it into another.

Senator KERR. $3½ billion now received in excise taxes are, in reality, probably one-third from moneys paid by the Government now, is it not?

Mr. HENDERSON. It is not that high.

I might say that our committee tried to get that information for quite a long time from the Federal Government, from the Treasury, and from any other source, and we did not find it available, and I think your committee staff has had about the same difficulty.

Senator BYRD. If we spend $85 billion in the fiscal year after this, we are told we will spend, and 60 or more of that would be for military, practically all of that would be included in these figures, would it not, in the base figures that you have?

Mr. HENDERSON. It would not—that $60 billion you have got both your housekeeping and your material. You are buying a lot of——

Senator BYRD. Of course, then the other departments of Government buy, make purchases that would be included, so that would balance it off.

Mr. HENDERSON. My rough guess, Senator, is——

Senator BYRD. It would be pretty nearly 50 or 60 billion dollars.

Mr. HENDERSON. When it comes to 5 percent, as it is now 5 percent on the broader base would be no higher than what the Government is paying now, you see; so that if you undertook to get a realistic picture of the net of the excise taxes, and applied it against our proposal, I think that you would find that we came out about the same.

Senator MILLIKIN. Roughly speaking, even on the wage side of the Federal Government's operations, we have to increase the wages as the living costs of the employees mount—so one way or another, you get caught with that tax. You either get it by the direct purchase of materials, or you get caught because it reflects itself in increasing costs of living of the workers.

Senator BYRD. The sales to the States is another question. Is it not true that the Secretary of the Treasury has the right to exempt the collection of the Government tax on a good many of the excise taxes now?

Mr. HENDERSON. That is correct.

Senator BYRD. What about the sales to the States? Does this contemplate, this estimate of revenue, include the sales to the States?

Mr. HENDERSON. Yes.

Senator BYRD. Well, you cannot tax a State, can you, on a direct excise?

Mr. HENDERSON. This contemplates only a part of this because this figure, Senator, is built up mainly of sales at retail, and it is built from the personal-consumption expenditures. But to the extent that the Government or a State bought things which are now personal consumption items——

Senator KERR. At retail?

Mr. HENDERSON. At retail, they would pay——

Senator BYRD. But you have no breakdown here to show——

Mr. HENDERSON. They would not pay at wholesale.

Senator BYRD. To what extent your figures include sales to States and sales to the Federal Government, have you?

Mr. HENDERSON. I would be glad to furnish that to you, but it would not represent the total amount of Federal purchases of goods which I think Senator Kerr is suggesting, because our table is built on the personal-consumption expenditures. The 5-percent tax would only affect those that the Government bought, commodities ordinarily which are personal expenditures, and which are sold at retail; bought at wholesale the Government would not pay the tax.

Senator BYRD. I suggest though that is an area that should be examined because we will be spending soon about a hundred billion dollars a year, which is about a third of the total national income, and that will be spent by the Federal Government and the State and local governments.

We want to see to what extent your estimate here will be changed if you do not include that tax to be collected from the Federal, State, and local governments.

Senator KERR. Does not the State and local government now pay excise taxes on those items which carry it?

Mr. HENDERSON. Yes.

Senator BYRD. Well, the Secretary of the Treasury has the right to exempt certain items.

Mr. HENDERSON. He can, but it is true that for the most part they are paid today.

Senator BYRD. You take a gasoline tax; I do not imagine a State would pay a Federal gasoline tax for it. They just get a refund for it, just like a farmer gets a refund if the tax is not used on his road.

Mr. HENDERSON. That is right.

Senator BYRD. Although those things should be taken into consideration, and I believe it needs a little further study along that line——

Mr. HENDERSON. Yes; but I want to make sure I am understood. Our base that I suggest is what is predominantly and overwhelmingly personal expenditures, and it would be only where the Government bought those items, and at retail, you see, that it would pay.

Senator BYRD. But outside of the personal services, in the armed services, they are direct purchases, of planes, automobiles, tanks, and everything.

Senator KERR. Mr. Chairman, Mr. Henderson's estimate is based upon an estimate of the amount of income of the Americans that is devoted to the purchase of those items that he figures would be covered by this tax.

Mr. HENDERSON. That is right; and that——

Senator KERR. At retail. In other words, there is a certain percentage of every American's income which is estimated to be used to buy food and shelter and medicine; that is not included.

Senator BYRD. This is not a retail sales tax that you are proposing.

Mr. RUTHENBURG. Yes; it is.

Senator KERR. It is.

Senator BYRD. How would it be collected? through the stores as other retail taxes?

Mr. RUTHENBURG. Yes, sir.

Senator KERR. Then he estimates that a certain percentage of that income is used to buy other commodities at retail, and that most of the $111 billion base that he has told us is the result of his calculations with reference to the percentage of Americans' income which they use in buying at retail those items.

Mr. RUTHENBURG. That is correct.

Senator BYRD. Then, of course, the tax on an automobile would be much more at retail than it would be at the manufacturers' level?

Mr. HENDERSON. No.

Now, the Federal tax now is $102, you see, and it also includes, as I say, $99 as costs which they have paid.

Senator BYRD. But the agent sells the car at a profit of $200 or $300; is that not true?

Mr. HENDERSON. That is true.

Senator BYRD. If you put that tax on the retail level you will be taxing that $200 or $300.

Mr. HENDERSON. But you will be taxing it at a lower rate. You will be taxing a $2,000 automobile and the wholesale price is $1,400 to $1,500, and the 7-percent tax is applied to that, and the House bill makes it 10.

Senator BYRD. I do not see how you can figure much reduction as between the 7 percent and the 5 percent if you put it on the retail level; I do not see that there would be much saving to the purchaser.

Mr. HENDERSON. It would be in the higher taxes than 7 percent which the company has to pay for electrical products, for radios, for heaters, which they say are $90 now.

Their estimate is that it is $90, which are the concealed taxes that they pay.

Senator BYRD. There is a straight retail tax, sales tax, in other words?

Mr. RUTHENBURG. That is correct, sir.

Senator BYRD. I see. You used the word "excise" tax, and it confused me.

I thought you meant an excise tax, such as we were discussing the other day on certain changes from the excise taxes we now have to an average of 5 percent.

Mr. RUTHENBURG. Senator, on page 3 of my statement I said that this is a retail sales tax.

Senator BYRD. Yes.

Mr. RUTHENBURG. But we suggest the name "defense emergency tax" so as to suggest clearly that it is one imposed for the emergency only.

Senator BYRD. I see. You can proceed, sir.

Mr. RUTHENBURG. Yes. I should like to briefly point out the fact that this proposed tax is not discriminatory.

Calling an excise tax "selective" is just a euphonious way of saying the tax is discriminatory. No matter how patient and thorough the study of the problem, a "selective" sales tax is always unfair and discriminatory. It is not possible to divide up America's products into the more essential and the less essential; and then to subdivide the "more essential" into those which are just "more essential" and those which are "most," and to subdivide those still further, which are "less essential" into those which are "least" and those which are just "less." But just that kind of Quixotic approach is required when we undertake to impose sales taxes "selectively"—under the Treasury approach—at various rates of 7 percent, 10 percent, 15 percent, 20 percent, and 25 percent.

Furthermore, in these United States yesterday's luxuries are today's necessities. Moreover, what is a luxury to one person is a necessity to another.

I would like to file for the record a table which points out many of the discriminations between the taxed and the untaxed. Discriminations of this kind come inescapably from any system of "selective" taxes.

To adopt the Treasury proposal of high rates on a few selected products would discriminate against low-income families—in fact it would "pocket book" ration many of them right out of the market for these particular products.

The Treasury proposal would discriminate as between competing business; some would become second-class industries.

On the other hand, if the tax is imposed at a uniform rate on a broad base, there is no unfairness or discrimination.

Next, it would retard inflation.

The defense emergency tax, which we propose, would curb inflation since it would discourage spending in a broad area of consumer expenditures.

If the tax isn't across-the-board, if it is put on just a few things—as the Treasury has recommended—it will simply transfer spending from items that are taxed at high rates to items that are not taxed. That will not stop inflation. That will just change the course of the inflation.

The defense emergency tax would run across the stream of spending. It would be imposed in that whole area where the supply of dollars presses against the less plentiful supply of commodities and services to cause inflation.

The defense emergency tax would divert into the Federal Treasury a part of the money that will otherwise continue to inflate our whole economy.

Senator MILLIKIN. What happens to the money after it gets into the Federal Treasury? Does it not continue to inflate?

Mr. RUTHENBURG. I beg your pardon, sir.

Senator MILLIKIN. I say, after you take it from the market and put it into the Federal Treasury, after it is put into the Federal Treasury, it then goes back to the same people, does it not, and it thus continues to inflate?

Mr. RUTHENBURG. I believe I have heard that endlessly debated, and I do not know that any sound conclusion has been reached.

Senator MILLIKIN. Thank you.

Senator KERR. It would not inflate nearly as much as it would for that amount of money to be left in the hands of the private consumers, and then for the Government to borrow or create additional money to buy those things that they would have paid for with the money that you are talking about, by taking it from the taxpayers, and using it to buy the things they are going to buy anyway.

Mr. RUTHENBURG. I believe that is correct, sir.

Senator KERR. It would reduce inflation to that extent.

Mr. RUTHENBURG. I think it would have the practical effect of reducing inflation pressures.

Senator MILLIKIN. I understood, Senator Kerr, it might multiply inflation. If you take this money away from the taxpayer and put it in the Treasury and then return it to the taxpayer in the form of wages and payments for goods, and so forth, the net result roughly speaking, is nothing. But if, on top of that, you have expanded your credit by inflationary issuance of bonds, for example, you have multiplied your problem rather than decreased it.

Senator KERR. There is no difference between us on that point.

Senator MILLIKIN. No; I may have misunderstood you.

Senator KERR. Here is the point I was trying to make: If the Government has to have an additional $15 billion, and that is merely a designated figure, with which to buy things that it needs, there is less over-all demand and less over-all competition for those items if the Government gets that money from taxpayers who are thereby reduced in what they can spend by that amount rather than by the Government's borrowing that amount of money and leaving the same amount of money in the taxpayers' hands, because then the Government uses its borrowed money to compete against the retained money in the taxpayers' hands to buy the same commodities that it otherwise would have bought with the taxpayers' money had it taken it by taxation and not obtained it by borrowing.

Senator MILLIKIN. I will accept that completely. The only thing that I was driving at is that we always hear that if we impose the type of tax you are talking about that it reduces inflation. It does for the moment. Then it depends on what the Government does with the money.

If the Government takes $10 from me as a wage earner by way of a tax, and then gives it back to me by way of salary, I still have the same amount of money to spend.

Mr. RUTHENBURG. I wonder, Senator, if that would not apply to taxes derived from any source? That is, the Government's revenue might come from various sources——

Senator MILLIKIN. I think you then get into——

Mr. RUTHENBURG. But taken from this source, it would probably have the better effect on the inflation than if it were taken from other sources.

Senator MILLIKIN. I think you then get into the question of degrees.

Mr. RUTHENBURG. Yes, sir; I agree with you.

Senator MILLIKIN. You get into the question of degrees of the velocity of spending, and when you get into that you get into an endless morass, but the end point is that after one or two stages it all comes to the same thing; it comes back to the consumer.

Mr. RUTHENBURG. I think it is generally accepted——

Senator MILLIKIN. Is that not reasonably sound?

Would you not say that was reasonably sound, sir?

Mr. HENDERSON. Yes, sir.

Mr. RUTHENBURG. Yes. I think it is a generally accepted fact that the inflationary effect of collecting taxes is less than the inflationary effect of increasing the debt and the money supply.

Senator MILLIKIN. That is true.

That is, depending on how you borrow the money.

Mr. RUTHENBURG. Yes, sir.

Senator BYRD. It is my understanding that you propose a collection exclusively on the retail level.

Mr. RUTHENBURG. Yes, sir.

Senator BYRD. On the retail level?

Mr. RUTHENBURG. That is right, sir.

Senator BYRD. Suppose things are sold at wholesale, what then?

Mr. RUTHENBURG. No tax until it reaches the retail level.

Senator BYRD. Well, then, could a consumer then purchase a farm tractor at wholesale and not pay any tax, but if it went through a retailer he would have to pay a tax?

Mr. RUTHENBURG. Well, I should say that a consumer purchase must be regarded as a retail purchase.

Senator BYRD. You just said, though, that a wholesaler, if you bought it at wholesale, you just said you would not pay any tax.

There is a good deal of difference between a sale at wholesale——

Mr. RUTHENBURG. We assume the man who buys wholesale would be a distributor and dealer.

Senator KERR. Buying for resale and——

Mr. RUTHENBURG. That ultimate consumer would be buying for retail.

Senator BYRD. In other words, this is a retail sales tax.

Mr. RUTHENBURG. Very definitely.

Senator BYRD. And it is collected from the retailers, and not from the manufacturer?

Mr. RUTHENBURG. That is correct.

Senator BYRD. And it is the same kind of a tax that practically every State is getting now.

Mr. RUTHENBURG. Yes, sir; 20 States, I believe.

We are not unmindful of the fact that the National Association of Manufacturers advocates a manufacturers' tax.

We are convinced that if the tax is imposed at the manufacturers' level, it will be pyramided, and inflation will be increased at every step of the mark-up as the commodity moves through the channels of distribution to the final customer. I know that some people will say that it need not be pyramided, but the plain fact is that a manufacturers' tax is an item of cost and, like the rest of the cost, it is pyramided.

Anyone in the business of manufacturing, or wholesaling, or retailing, knows that this is one of the A B C's of American business procedure.

A manufacturers' tax inflates the inventory figures and inflates the mark-up on each transaction. If anyone doubts it all he has to do is to have a look at our experience with the present manufacturers' taxes, or at the Canadian experience, which shows clearly that their tax is pryamided.

Our committee has studied the Canadian experience; some of our members have subsidiaries in Canada. We know that the Canadian manufacturers' tax is pyramided.

That is explained here in detail but I will not go into detail.

Senator BYRD. Have you made an estimate with respect to the House bill, after you made these changes, and canceled part of the House taxation, and replacing it with this, as to what would be the net increased revenue for the Government?

Mr. RUTHENBURG. We made no definite recommendation, except to supply them with the data upon which their own computations can be made and, as Mr. Henderson has made, and upon their assumptions as to taxable commodities, a 5-percent tax would produce something in excess of 5 billions.

Senator BYRD. Mr. Stam estimates that it will only be $300,000,000 additional revenue.

Mr. RUTHENBURG. Under the present proposals?

Senator BYRD. Yes, sir.

In other words, I believe if you strike out the House bill—strike out those things that your proposal contemplates, and substitute yours, we would only get 300,000,000 more than we would get under the House bill?

Mr. RUTHENBURG. Can you reconcile that statement?

Mr. HENDERSON. I know I cannot reconcile it because the net increase by the House bill calculated, I think, a net of 1.1 billion, is that not it?

Mr. STAM. 1.2 billion, and you had 1.5 billion net, you see, so that difference would be 300,000.000.

Mr. HENDERSON. No, I had a 1.5 billion based not with the House increases in it.

I say that the commodities to which we are applying—to which I applied the Curtis analysis, would produce something in excess of a billion and a half more than is presently being produced.

Senator BYRD. I see.

Mr. STAM. That is a billion and a half compared to the 1.2 billion additional of the House.

Mr. HENDERSON. Yes. I take no account of the House estimates on the 1952 revenue, and the estimates of what would be yielded, you see, would be higher, certainly, with increased business; but, if you want to say that 5 percent produces in the neighborhood of a half billion more than the House bill, I think that I could accept it. If you are only going to raise this amount of revenue from excises, the 5 percent would only raise a half billion dollars more than the House has already provided.

Mr. Stam, we are completely in agreement on that.

Mr. STAM. That is what I thought. You are just comparing one method with the other, that is all.

Mr. HENDERSON. That is right. We compared it with the House bill, and with the Treasury's proposals, you see.

Senator BYRD. What is your estimate of net increased revenue above the House bill?

Mr. HENDERSON. About half a billion, my estimate is.

Senator BYRD. That is only $200 million more?

Mr. HENDERSON. That is right, as far as the House excises are concerned here.

Senator BYRD. It is pretty close to the estimates we get around here, which is $200 million.

Go ahead, sir.

Mr. RUTHENBURG. Let me mention an enigma in the Treasury position.

Like the NAM the Treasury has recommended manufacturers' taxes—but to be applied "selectively" rather than uniformly. When the Secretary testified before the House committee in February he presented tables which assumed no pyramiding of proposed tax increases.

Nevertheless, the Secretary has recently advised the Senate Finance Committee that if a general sales tax is enacted it should be imposed at the retail rather than the manufacturers' level since taxes on the retail product avoid pyramiding due to retail mark-ups, and also tend to disturb the price ceiling program less.

The Committee for Economic Development—with whose position on excises we find ourselves in general agreement—has stated that it is fundamental both to tax policy and to stabilization policy that the new or increased excises should be excluded from the measurement of the cost of living in any controls that link wage increases to the cost of living. This is possible with a uniform retail tax, but not with a manufacturers' tax.

Next, I would like to point out it is administratively feasible: That it requires compliance by many businesses, not few, is scarcely an objection when we consider that the mainstay of the Federal Treasury is the income tax, which is composed of many times as many taxpayers. Innumerable businesses—drugstores, retail stores, and so forth—now comply with the hodge-podge of "selective" sales taxes; it would be easier for all if the tax were at a uniform rate on a broad basis. In 29 States and the District of Columbia businesses and individuals are already accustomed to this type of tax. Its feasibility is underscored by the fact that against the background of years of knowledge, discussion, and experience, the use of the sales tax has increased, not decreased. In a democracy that is the acid test.

The defense emergency tax would no more interfere with the State sales tax than the Federal income tax interferes with the State income taxes (imposed in 31 States and the District of Columbia) nor than the Federal gasoline tax interferes with gasoline taxes imposed by all the States.

Perhaps the final test is: What do the retailers themselves say? Like our own National Committee for Fair Emergency Excise Taxation, they are normally opposed to all Federal excise taxes, but the American Retail Federation, representing the retailers of the country, have gone on record as favoring an across-the-board retail excise tax, limited to the emergency.[1] And they have done this with the full realization that they will be the ones on whom the burden will fall to collect it.

It would be earmarked for the emergency only. The fact that the hodge-podge of "selective" taxes is still on the books 10 years after these taxes were first imposed in preparation for World War II, and the fact that they are the only tax category which was not reduced after the war was over, is proof of the difficulty of getting such taxes out of the tax structure. And this is in the face of the fact that they have been marked for removal by the President, the Senate Finance Committee, the House Ways and Means Committee, and Congress as a whole—all with the active support of the AFL, the CIO, the CED, our own group, and many others.

Because manufacturers' taxes (both those advocated by the Treasury and those advocated by the NAM) are hidden taxes, and because they would tend to become permanent taxes, we oppose them.

We believe that the defense emergency tax which we propose should have an expiration date written into the law which enacts it. This would require reexamination of the tax in order to continue it.

We believe the law should carry a strong statement of congressional disapproval of Federal excise taxes except as an emergency measure for the defense of the country.

The defense emergency tax would be the means of raising substantial revenue for defense, and then, since it would undoubtedly be repealed when the emergency is over, it would be the means of ultimate elimination of excises from the Federal tax system.

That, gentlemen, concludes our testimony, and we express our ap-

[1] Statement of John F. Lebor to this committee: If as a result of adopting these principles there is a need for a substantial amount of revenue which cannot be made up by increased efficiency and real economy, and if consequently the Congress decided to raise this amount by the use of excise taxes, then a broad, biased excise tax, at the retail level without exemptions, is the proper method to select.

preciation for your having heard us. If you have any questions, I would like to answer them.

Senator MILLIKIN. Mr. Chairman, I would like to ask Mr. Henderson if he would like to send us a letter or a memorandum on the pass-down burden of a sales tax in connection with the whole subject of tax burdens on the lower-income brackets?

Mr. HENDERSON. I would be very glad to send that to you. As I say, I have done quite a bit of work on burden, but I have done more work on the excise tax burden because it is very——

Senator MILLIKIN. The job to be done at the expense of your clients. [Laughter.]

Mr. HENDERSON. I might say that my clients have wanted me to examine all the related items to make sure that their proposal was a sound one; that it met all the challenges of the NAM proposal, or the Magill proposal, or any of those.

Mr. RUTHENBURG. May I say, that we have asked Mr. Henderson to go into all sorts of collateral issues, so that we could not get a distorted view of this thing.

Senator MILLIKIN. That kind of information will be useful to the committee.

Senator BYRD. Mr. Henderson, I would like you to add to that the statement of the reductions that would be incurred in existing taxes—under the House bill, what the laws would be in each category, and then the increases to take the place of that.

I may say that this only brings in the sales tax of 5 percent which would give a net revenue of three to five hundred million dollars, and we have got a prospective deficit of six or seven billion. That will not go far toward paying that deficit.

Mr. HENDERSON. Well, Senator, if I recall correctly, Mr. Ruthenburg said that if this committee finds that it needs additional revenue from the consumption tax, then it can look to the retail tax. The 5 percent is not the recommendation of our committee. We have said that you can easily measure from this base, based on about a billion for each percent, for each percentage point.

Senator BYRD. That would be a pretty burdensome tax, 5 percent, is that not right? Is there any State that has as much as 5 percent?

Mr. HENDERSON. No, but the Federal Government is charging 20 percent now on many items at retail.

Senator BYRD. In this case they are supposed to be a luxury class. Whether or not they are, that is a supposition. That will go on the necessities of life, outside of food. Does it apply to clothing?

Mr. HENDERSON. It applies to clothing.

Senator BYRD. Food and medicine are exempted?

Mr. HENDERSON. Food, medicine, and shelter.

You might be interested—I am not submitting this for the record, but the question I asked——

Senator BYRD. You would not advocate a 10-percent retail sales tax, would you?

Mr. HENDERSON. We would advocate whatever revenue the Federal Government seeks to obtain from the excise taxes that it gets by applying whatever uniform rate is necessary. Our advocacy——

Senator BYRD. I mean the proposal of 5 percent; does that mean with a small balance, but it does not improve the fiscal condition of the Government because it only adds about three to five hundred million dollars of increase?

Mr. HENDERSON. Yes, sir. But we did not propose the five. Congressman Curtis asked the question.

Senator BYRD. What figure do you propose?

Mr. HENDERSON. We do not propose any set figure. We say that in your deliberations you have three broad groups from which you are going to draw additional revenue.

Senator BYRD. Where did this 5-percent figure come from in the discussion?

Mr. HENDERSON. Congressman Curtis, in the Ways and Means hearing, asked if I would prepare for him an estimate of a 5-percent retail sales tax with exemption of food, clothing, medicine, and the traditionally accepted items.

Now that estimate is in the hearings before the House at page 1842. Then I submitted to Congressman Curtis in a letter, a copy of which I have here, all the things that we included and all the things that we excluded, which still left a base of $111,640,000,000, as I say, which is, roughly, three times what is taxed now. I would like to give this to you.

Senator MILLIKIN. Mr. Chairman, I would like to have him put in in the record, if he has no objection.

Senator BYRD. Put it in the record.

Senator MILLIKIN. This is not in the House record? I think it would be useful to put this letter into the record.

Senator BYRD. Do you have it in condition to submit?

Mr. HENDERSON. I can furnish it within a short time.

Senator BYRD. Then this other information I would like to have also from Mr. Henderson.

(The information referred to follows:)

AUGUST 13, 1951.

Senator HARRY F. BYRD,
Senate Finance Committee, United States Senate,
Washington 25, D. C.

DEAR SENATOR BYRD: At the conclusion of the testimony before the Senate Finance Committee on excise-tax legislation by Louis Ruthenberg and myself, for the National Committee for Fair Emergency Excise Taxation, you were kind enough to ask me to prepare a statement for the record. This statement, as I understood it, was to indicate the changes which would take place in the excise-tax structure if the National Committee for Fair Emergency Excise Taxation proposal for a retail sales tax were substituted for most of the present selective excises at the manufacturing and retail level, and those on services, such as communications, transportation, admissions, etc.

I am pleased to submit my calculations in three tables below.

Fortunately, the computation I prepared at the request of Representative Curtis for the House Ways and Means Committee provides a basis for comparing the effect of the plan suggested by the National Committee for Fair Emergency Excise Taxation. (See table A, p. 1842, House Ways and Means Committee hearings, 1951.) This computation shows an estimated revenue of $6,082,000,000 from his suggested 5-percent retail tax for a full year operation in fiscal 1952, and this figure is used in all three tables below. The assumptions employed appear with the computation in the House hearings.

The products and services which are included and excluded appear in detail in a table inserted by me at the suggestion of Senator Millikin and yourself at the end of Mr. Louis Ruthenberg's testimony before the Senate Finance Committee on August 8, 1951. (The table is headed "Goods and services included and excluded in tax base of $111,640,000,000 used by Leon Henderson for estimate of revenue from 5-percent retail sales tax.")

SUMMARY

In brief, the three tables below indicate that a 5-percent retail tax would yield the following:

(*a*) Total excise revenue of $2.2 billion more than the present law (table 1).

(*b*) Total excise revenue of $2 billion more than the House bill, assuming identical yields from increases for alcoholic beverages, tobacco products, gasoline and oil, the new wagering excise, and other House bill changes (table 2).

(*c*) Total excise revenue of $700 million more than the House bill, without the additional revenue from other categories provided by the House bill. (Discussion following table 3.)

(*d*) Total excise revenue in excess of the Treasury 1951 proposals for increases in selected commodity excise rates. (Discussion, table 8.)

TABLE 1 AND DISCUSSION

TABLE 1.—*Comparison of estimated excise tax yields for full fiscal year from present excise legislation and from a 5-percent tax at retail on selected goods and services, assuming present rates on alcoholic beverages, tobacco products, gasoline and oil, transportation of property, and electrical energy, and assuming a 25-percent cutback in principal durable goods.*

[In millions]

	Present law	Assumed 5-percent retail tax	Differences
Alcoholic beverages	$2,400	[1] $2,400	0
Tobacco products	1,470	[1] 1,470	0
Gasoline and oil	750	[1] 750	0
Other manufacturers' excises	1,343	0	−1,343
Retailers' excises	513		
Miscellaneous	1,978	6,082	+3,591
Stamp taxes	100	[1] 100	0
Total	8,560	10,808	2,248

[1] Identical with estimates under present law because National Committee for Fair Emergency Excise Taxation makes no proposals for changing the rates in these categories.

The estimate of fiscal 1952 yield from existing excise legislation of $8,560,000,000 is my new estimate. It is slightly higher than the Treasury estimates, but I believe it will closely correspond with the forecast of the staff of the Joint Committee on Internal Revenue.

No increases have been included in the estimated retail-tax yield for transportation of property or for electrical energy, whose rates are below 5 percent now. Nor does it include revenue from excises on sugar, narcotics, and several other miscellaneous taxes which in fiscal 1951 yielded approximately $125 million.

TABLE 2 AND DISCUSSION

TABLE 2.—*Comparison of estimated excise-tax yields for full fiscal year from (a) present laws plus House bill changes and from (b) a 5-percent tax at retail on selected goods and services (assuming 25-percent cut-back in principal durable goods), assuming present rates on transportation of property and electrical energy, and assuming revenue changes from House bill on alcoholic beverages, tobacco products, gasoline and oil, wagering, etc.*

[000,000 omitted]

	Present law	Increases under House bill	Total under House bill	Assumed 5 percent retail tax	Difference
Alcoholic beverages	$2,400	$252	$2,658	[1] $2,658	0
Tobacco products	1,470	177	1,647	[1] 1,647	0
Gasoline and oil	750	220	970	[1] 970	0
Other manufacturers' excises	1,343	227	1,570	0	−$1,570
Retailers' excises	513	−5	508		
Miscellaneous	1,978	[2] 381	2,359	[3] 6,482	+3,615
Stamp tax	100	0	100	[1] 100	0
Total	8,560	1,252	9,812	11,857	2,045

[1] Identical with estimates under House bill because National Committee for Fair Emergency Excise Taxation makes no proposals for these categories.

[2] Reflects primarily estimate of $400 million to be derived from wagering together with increases and decreases in other items.

[3] Includes estimate of $400 million from wagering as in House bill and $6,082 million as in Curtis memorandum.

The estimate of "increases under House bill" of $1,252 million is taken from the Committee on Ways and Means "Summary of the provisions of H. R. 4473 (revenue bill of 1951)."

The estimate of $6,482 million revenue from an assumed 5 percent retail tax represents my estimate of $6,082 million, plus the $400 million expected revenue from the new wagering tax.

My retail tax estimate includes the existing electrical-energy excise, which the House bill repeals. This represents about $100 million, which I have assumed to be offset by the some $125 million revenue from sugar, narcotics, etc., which do not appear in my estimates anywhere.

TABLE 3 AND DISCUSSION

In table 3, below, are listed those categories of manufacturers', retailers', and miscellaneous excises whose rates would be reduced to 5 percent if a 5-percent retail tax, across the board, were substituted. Existing excise rates on these categories appear in detail in table 2 of Secretary Snyder's testimony before the House Ways and Means Committee on February 5, 1951 (p. 10, House hearings, 1951).

TABLE 3.—*Categories of excise taxes whose existing rates would be changed by adoption of an assumed 5-percent retail excise tax, used in projection for Representative Curtis*[1]

(Category designations from Treasury Department Form 7005, monthly release Collections of Internal Revenue)

Manufacturers' excise taxes:
- Tires and tubes
- Automobile trucks and busses
- Other automobiles and motorcycles
- Parts and accessories for automobiles
- Electric, gas, and oil appliances
- Electric light bulbs and tubes
- Radio sets, phonographs, components, etc.
- Phonograph records
- Musical instruments
- Mechanical refrigerators, air-conditioners, etc.
- Business and store machines
- Photographic apparatus
- Sporting goods
- Firearms, shells, and cartridges
- Pistols and revolvers

Retailers' excise taxes:
- Furs
- Jewelry
- Luggage
- Toilet preparations

Miscellaneous taxes:
- Telephone, telegraph, radio, cable, leased wires, etc.
- Local telephone service
- Transportation of persons, seats, berths
- Leases of safe-deposit boxes
- Admission to theaters, concerts, etc.
- Admission to cabarets, roof gardens, etc.
- Club dues and initiation fees
- Bowling alleys, pool tables, etc.
- Coin-operated devices

The categories of excise taxes listed in table 3, above, yielded revenue of $3.4 billion in fiscal 1951. With the addition of revenue from the categories "transportation of property" and "electrical energy," the yield was $3.8 billion in fiscal 1951. It is this latter figure of $3.8 billion which is to be used for comparison with the yield of a 5 percent retail excise tax, which is calculated (p. 1842, House hearings 1951) to be $6 billion for fiscal 1952.

[1] Table A, page 1842, hearings, part 3, Revenue Revision of 1951, House Committee on Ways and Means.

(NOTE.—No rate change was suggested for categories "Transportation of property" and "Electrical energy," both of which are currently taxed at less than 5 percent.)

In other words, the proposal of the National Committee for Fair Emergency Excise Taxation for substitution of an across-the-board, uniform retail tax, with liberal exemptions, would produce at the assumed 5 percent rate over $2 billion more revenue than was collected from selected commodities and services in fiscal 1951.

From these same selected categories (which do not include alcohol, tobacco, or gasoline) the Treasury proposals made to the House Ways and Means Committee on February 5, 1951, would be expected to yield $4.9 billion in fiscal 1952. The 5 percent retail tax, as projected for Representative Curtis, would yield more than a billion dollars more than the Treasury request for 1952 from these categories, without imposition of the unprecedentedly high, selected rates asked by Secretary Snyder.

The fiscal 1952 estimated yield under the House bill of the categories listed in table 8 may also be compared with the $6 billion estimate of a 5 percent tax at retail. The House bill provides for new revenue, on a full-year basis, of $1.2 billion. Of this $1.2 billion, it is estimated that $400 million would come from the new wagering excise, and from increases over present rates there would come additional revenue of $252 million from alcoholic beverages, $177 million from tobacco products, and $220 million from gasoline and oil. Thus a total of about $1,050 million increase would come from categories not included in the $6 billion retail tax calculation.

Under the House bill, total excise revenue for fiscal 1952 would be in the neighborhood of $9.8 billion. The estimate of total excise revenue I supplied Representative Curtis (p. 1842, House hearings) was $10.5 billion. No rate increases in any category whatsoever was assumed in this $10.5 billion estimate. Therefore, if the only excise-rate change adopted were that of substituting the retail excise tax at 5 percent for the present hodgepodge of selective rates, this change would produce $700 million more than the $9.8 billion which the present House bill provides.

I estimate that the House bill would provide excise revenue of $3.9 billion in fiscal 1952 from the categories listed in table 8, above. If this estimate is correct—and I believe it will closely correspond with the estimate of the staff of the Joint Committee on Internal Revenue—then the proposal as calculated for Representative Curtis would yield over $2 billion more than the House bill for the same categories.

Sincerely yours,

LEON HENDERSON.

AUGUST 13, 1951.

Senator EUGENE D. MILLIKIN,
Senate Finance Committee,
Washington, D. C.

DEAR SENATOR MILLIKIN: When I appeared before the Senate Finance Committee on August 8 on behalf of the National Committee for Fair Emergency Excise Taxation, you asked me to submit a letter on "the pass-down burden of a sales tax in connection with the whole subject of tax burdens on the lower-income brackets."

As I indicated, I have made no original studies of tax burdens on different income classes, but I have analyzed the all-too-few surveys which have been made, and the technical criticisms of these which are available. The material below flows from my observations and statistical analyses of my associates, Mr. and Mrs. E. R. Lerner.

One conclusion is abundantly clear, and this is that the disagreements between those who have studied the subject are so pronounced that the Congress has no exact basis on which to rely, if an exact basis is required for national tax policy.

The disagreements stem from (*a*) choices of statistical tools and (*b*) differing economic theories as to the ability to shift taxes, and to allocate the shifts by economic and income classes.

One of the most acute conflicts revolves around the relative burden of taxation on the extremely low income groups and on those with incomes above $7,500. My opinion, which is elaborated below, is that spending units with less than $1,000 cash income differ very markedly from those which include most worker families, and their patterns of spending differ also. Then, too, to lump all incomes above $7,500 and assume these have identical patterns of spending is to blink at realities.

There is no doubt in my mind that the burden of taxation falls very heavily on low-income spending units, and that hidden taxes, plus the pyramiding of tax costs at other than retail levels, tends to conceal the real weight of this burden. The progressivity of personal income tax exemptions only offsets a part of the burden. I have pointed out elsewhere that low-income units buy substantial quantities of automobiles, refrigerators, and other household appliances. The sheer money outpayments for taxes on these items will claim large shares of current income of any low-income buyer.

Sometimes the dispute over relative burdens of taxation gets bogged down in the dispute over "regression." Roswell Magill gave an excellent discussion of the confusion over exise tax regression when he appeared before your committee at these hearings.

Frankly, I am not convinced that the Federal tax system is especially regressive on incomes below $1,000, for example. But I am convinced that spending units in this group bear heavy burdens from taxation, and, in addition, the burden is compounded by the relation of prices to their total income. Such units lose buying power for many reasons: they pay highest prices, get fewer discounts, pay installment charges, pyramided taxes, and other dilutions of real purchasing power.

To measure with exactness the regressivity of a new tax on various income classes is not possible at this time. But to choose a system of taxation on consumption which will not add to the already heavy burden of low-income classes can be done.

INCIDENCE

Who pays the taxes? is the question that is involved in all discussions of tax incidence, for it is generally conceded that the individual who makes the monetary payment of a tax may be able to shift the payment to other individuals and thus recoup in part or in whole the amount of money he has paid out. He may not be able to shift the total amount of the tax; he may not be able to shift every kind of tax. The problem of incidence is thus the problem of the shifting of the money expenditure for taxes.

It is understood that the monetary payment of the tax is in a sense not a true statement of the burden because all individuals derive the benefits of Government activities.

This letter is concerned only, however, with the monetary burden among different income groups and the shifting that may come about among income classes and more specifically with the shifting of excise taxes. Thus this letter is concerned with the impact or burden of excise taxes on individuals and families measured in dollars that are expended for taxes in relation to their total income.

There are numerous and serious problems involved in any analysis that seeks to measure the burden. In the first place total income must be measured and this would mean all money income, including money gifts, and all income in kind. Excluding either of these raises the ratio of burden to income and actually distorts the true picture. There is actually little precise information on the expenditures of individuals and families (whose patterns may be quite different from one another) on presently taxed items. What information is available is fragmentary and spotty, reflecting largely expenditures of families in urban centers.

The measurement of the degree of shifting is also complicated by other factors. The stage of the business cycle, the elasticity of demand, the competitiveness within industries, the ability of consumers to obtain substitutes for taxed items, and the presence of a buyers' or sellers' market all have an effect on the degree to which a tax may be shifted.

CONGRESSIONAL STUDY NEEDED

To me it is quite clear that the Congress, faced with almost inevitable consideration of raising substantial new revenue, should take responsibility for a burden study of its own. At present, the most widely quoted conclusions are those contained in the Musgrave report, mentioned above. This practice runs the very real danger that Dr. Musgrave's extensive cautions will not be quoted also. The Musgrave report has added considerably to the fund of knowledge on tax burden. It has also stimulated additional surveys and critical review. One of the most challenging reviews, which I have analyzed in advance, will appear as an article by Rufus Tucker in the forthcoming September issue of the National Tax Journal. When the Musgrave and Tucker articles are read together, they will fortify my recommendation for a congressional study.

TAX BURDEN

Despite the great political and economic importance of an understanding of the tax burden on American families and individuals relatively few comprehensive studies of this type have been made. Among the most noteworthy are:

TNEC Monograph No. 3—Who Pays the Taxes, Gerhard Colm and Helen Tarasov, 1940.

Social Research, Supplement IV, Who Does Pay the Taxes, Tarasov, 1942.

The Fiscal System, The Distribution of Income and Public Welfare by John H. Adler, Chapter in Fiscal Policies and The American Economy, edited by Kenyon E. Poole, 1951.

Distribution of Tax Payments by Income Groups: A Case Study for 1948, by Richard A. Musgrave et al; National Tax Journal, March 1951.

All of the studies attempted to demonstrate statistically the incidence or burden of all taxes (Federal, State, and local), after full consideration of various assumptions. Nevertheless, the authors fully recognized the limitations of such treatment of so complex and involved a problem. In this connection it is well to recall the rather cogent series of observations contained in the opening chapter of the TNEC study to the effect that "*even the most complete statistical material can never measure the incidence of taxation. The incidence of taxes can be derived from figures on tax payments only on the grounds of theoretical reasoning and hypothetical conjecture. Whatever statistical refinement is achieved, therefore, the results necessarily rest on a number of assumptions.* The incidence of taxation depends, among other factors, on the degree of competition and monopoly prevailing in an economy, on the direction of Government regulation of prices and cost factors, on the general trend of economic growth or stagnation, on the development of labor productivity, on the time which has elapsed since the introduction of new taxes, on the increase (or decrease) in tax rates, and finally, it depends on the use made of taxes and on the other fiscal policies (e. g. borrowing) pursued at the same time." [Italics mine.]

The most recent of the studies—that by Musgrave—has been attracting a good deal of attention not only because of its comprehensiveness but also because it differs in several important respects from the assumptions and techniques used in other studies.

Many users of Musgrave's conclusions are failing to keep in mind his own cautions that different conclusions may have been reached with other assumptions and statistical methods. In particular he expresses emphatic cautions with respect to his results which reflect incomplete consumption expenditure patterns, methods of distributing corporate tax payments, and allocating of payroll and property taxes. Furthermore, he recognizes the difficulties of interpreting results obtained both at the bottom of the income scale, because of the heterogeneity of the composition of the low spending unit brackets, and the top income bracket which combines all groups having $7,500 or more.

Musgrave's concepts as to what constitutes the income base, what types of taxes are shifted from the payer to other economic classes, to whom they are finally shifted, and how the taxes so determined are to be allocated and distributed are areas of major differences with other studies.

That his results differ from those of the pioneer TNEC study is not surprising. Even if there were no major differences in assumptions, the income distribution, the expenditure patterns, and the tax structure were so radically different in 1938–39 that the surprise would have been much greater had the results been similar. Moreover, the statistical tools available to the TNEC authors were indeed blunt instruments. In addition, in the controversial area of corporate income tax, the TNEC study assumed that such taxes were not shifter, whereas Musgrave assumed they were in his "standard case." [1]

A better evaluation of Musgrave's final results is afforded by comparison with the equally contemporary study by Adler. While the latter study does not describe its assumptions and techniques in nearly as great details as Musgrave, it is clear that it departed in several respects from Musgrave. As a consequence, the results of the Adler study are markedly different from Musgrave. While both find the over-all tax structure (Federal, State, and local) to be regressive at the lowest bracket—under $1,000—the Adler findings show a fairly sharp progression thereafter, whereas Musgrave's "standard case" carries forward almost on a proportional basis from $2,000 through $5,000 and shows fairly sharp

[1] Represents from among several alternatives the assumptions and methodology Musgrave regards most applicable.

progression thereafter. Throughout, the impact of all tax payments on various income classes is lower in the Adler study than in the Musgrave study, except in the highest income class of $7,500 and over, where they coincide.

These varying results are due to several important differences in assumptions and statistical methods. First, Adler uses the Department of Commerce series for his income base, which provides a higher figure than the source used by Musgrave, namely, the Survey of Consumer Finances of the Federal Reserve Board. Second, the basic data selected to represent expenditure patterns differ. Adler uses throughout the Bureau of Labor Statistics studies of three cities made in 1947 exclusively whereas Musgrave uses the Survey of Consumer Finances study for general expenditure patterns and BLS (for nine cities) and SCF for specific expenditure patterns. Since the patterns used by each differ considerably, any allocation of a certain type of tax payment by either of these methods will result in different distributions. Finally, Adler assumed—as did TNEC study—that corporate taxes were not shifted, contrary to the Musgrave concept. Since corporate taxes represented about 30 percent of the Federal tax collections in 1948 and about 23 percent of total Federal, State, and local taxes, it is understandable why patterns of burden will vary, depending upon the treatment of corporate income taxes as far as shifting is concerned.

Quite apart from the comparisons, and confining ourselves strictly to the Musgrave study, several observations are worth mentioning. Furst there is a finding that the pattern of effective rates shows sharp regressivity (on an over-all basis) at the lowest income level of "under $1,000"—a finding supported by the other studies. Just who are the families or individuals with incomes of less than $1,000 annually has challenged the curiosity of many, including several members of Congress. A considerable amount of statistical evidence is available that shows how dissimilar in composition this income class is: nearly half were single, 35 percent were over 65 years of age; 51 percent lived in rural areas: about a fourth were farm operators; 35 percent received pensions, annuities, or relief, only 40 percent received wage or salary payments; and lastly nonmoney income was a substantial part of total income for this group. The composition of this group clearly differs substantially from that of all other income classes. Moreover, as evidence of their financial condition, about 50 percent owned their own homes. Under these conditions, the finding that total tax structure is regressive at the lowest income levels still requires an elaborate explanation to give it any significance. It is significant, however, that over-all effective rate for the lowest income class, as computed by Musgrave, is regressive almost entirely because of the impact of State and local tax rates on this income class. The burden of Federal tax payments is essentially a progressive one.

The Musgrave study points out the difference of $36 billion less between its personal income base and that of the Department of Commerce but does not fully explore the effects of that omission. Some idea of the significance of the omission is gained from the Adler-Musgrave comparison in which Musgrave adjusts his series to the Commerce Department level. The effect is to lower the effective rate for the lowest bracket by 5 percentage points and to narrow considerably the regressive pattern of his "standard" case. From another point of view, even this treatment of the $36 billion is not entirely satisfactory, since it is known that a very large portion—about $21 billion—went to the incomes below $7,500 and very likely bulked largest in the lower income classes. Consequently omitting these amounts from the income base of these classes resulted in increasing their effective rates of tax payments in relation to their low income.

Another area of doubt arises in connection with the assumption that undistributed profits of corporations should be regarded as income of stockholders. This has the opposite effect of the omission of income mentioned above in that it raises the income base of the higher income classes and therefore results in a lighter load. Whether income that never reaches the stockholders and furthermore which may not be reflected in appreciation in value of securities should be so regarded is debatable.

The statistical measures used by Musgrave in making his allocation of tax payments are frequently crude, as admitted by him. In a number of instances, he is compelled to rely on a general pattern of consumer expenditures to make his allocation—a pattern which is a derivative of the Survey of Consumer Finances—or on a pattern for a class of expenditures derived from a sample based on BLS studies of nine cities. While Musgrave expresses some concern over the reliability of the latter, he appears more confident of the former. While more reliable data will become available upon the completion of BLS studies now in progress, there is no basis for assuming that either measure was sufficiently satisfactory for the purpose for which it was utilized. There is, however, further doubt as to the validity of the use of BLS data for this purpose. While BLS data do show broad patterns, their application for very precise measurement can result in large statistical errors. Since these expenditure patterns are for urban families of two or more persons, their application to the low income groups is of dubious validity. Moreover, according to the latest census data, 18 percent of American "family units" are represented by individuals. A group of this magnitude cannot be assumed to have the same expenditure pattern as families of two or more persons, particularly when all known facts are to the contrary. All of these weaknesses are recognized by Musgrave but he finds no better alternative statistical measures.

The assumption that contributions made by employees covered under social insurance legislation are "tax" payments is also likely to prove highly controversial. About $4 billion are involved in this item, representing about 10 percent of Federal tax collections, a substantial part of which is for old-age retirement. Because of the limitation of contributions under this legislation to the first $3,000 (now $3,600) in wages and salaries, the tax is necessarily regressive and obviously increases the burden of tax payments in the lower brackets. Whether a mandatory tax of this nature should be regarded as a tax in the normal sense of the word is debatable, without getting involved in the larger question of benefits to the entire population derived from all tax payments as explored by Adler. In this instance, the tax is presumably a partial contribution toward a retirement or survivor benefit.

In either case, it can be regarded as a form of compulsory savings rather than a tax. It might be further deduced that such payments are not taxed in the true sense from the fact that Government payments under the social-insurance system are not subject to income tax and are not reported as income on personal income taxes. One argument for their inclusion as taxes is that the income derived on retirement is reflected in the various income distributions of the various income classes. The problem of classification is illustrated by consideration of the treatment of medical care under a social-insurance system. The individual subject to the tax for such purpose would shift from paying personally for medical care to paying taxes as medical care insurance. The same amount may be involved in each method of payment but where the former payment was merely an expenditure like any other not subject to excises, under the latter, the expenditures would be regarded as a "tax" payment. Perhaps the illustration becomes even sharper where an individual insures himself and family under a voluntary surgical and hospitalization system and has regular monthly deductions made from earnings—an optional expenditure. Should it become a mandatory deduction from wages under a social-insurance system, it would then be regarded as a tax, according to Musgrave's assumption.

EXCISES

A number of questions raised above with respect to the Musgrave general approach are equally applicable to consideration of his treatment of excises. If his theory and statistical methods have reduced the income base in the lower brackets, then the burden of existing excises—the percentage of income paid out in the form of these taxes—has been exaggerated. Because excises are identifiable and because the place of final payment is clearer than in other areas of taxation, however, there is less controversy over the assumptions on shifting of excises than elsewhere in the study. The same questions as to the applicability of general consumption expenditure patterns derived as a residual (money incomes less Federal income taxes and savings) from the income distributions of the Survey of Consumer Finances based on a small sample of the population or of specific consumption patterns derived from a miscellaneous group of nine urban centers are still pertinent.

With respect to the theory that all excises are shifted forward to consumers, the TNEC study agrees with this, in general but concedes that this is not necessarily true at all times—that prices may be held at a lower level under certain business conditions, thereby absorbing the tax in whole or in part. Having decided however, that all such taxes are passed on to consumers, Musgrave is still faced with the problem of determining how much is to be allocated to specific consumption items rather than to a general "catch-all," since in a number of instances, a sizable portion of the revenue from such sources come from business rather than consumer purchases.

The problem varies in degree for the different excises but is particularly acute for the categories yielding among the largest amounts of revenue—namely, automotive (e. g., gasoline and oil, trucks and busses, automobiles and motorcycles, tires and tubes, and parts and accessories), communication, recreation, and transportation. Only crude estimates, bordering on conjecture, could be used in making the separation between business and consumer purchases of such goods and services. Finally, having made the allocation, a dubious expenditure pattern is applied to obtain the necessary distribution of tax payments which can then be related to the income of each class. Because even small changes in the amount of tax payments allocated to the lower income classes produce widely varying results, it is essential that a revenue source of this magnitude be distributed as accurately as possible. One critic of the study, in accepting generally Musgrave's theory of shifting and incidence but modifying slightly a few assumptions regarding allocation, obtained a far different burden picture with respect to Federal excises than did Musgrave. Still other results were obtained when different sources of expenditure patterns of a more comprehensive nature though less recent date were used. In both instances, the distinctive U-shaped curve, indicating regressivity, at the lowest income level, of the Musgrave findings, disappeared. There was no distinct over-all tendency toward regression on excises until income bracket of $15,000 and over was reached.

On the burden of Federal excises, Musgrave, as do others, makes no special distinction for sumptuary taxes, such as those on alcoholic beverages and tobacco products. Of the total amount of $7.0 billion allocated to Federal excises, $3.5 billions were derived from these two categories. Since such taxes are characteristically regressive, inclusion with excises from other consumer expenditures is bound to yield a regressive pattern. If tax payments on such items were separated from the Musgrave distributions. the resulting pattern is essentially proportional between the $1,000 and $7,500 income classes, as shown below:

Spending unit income brackets—Tax payments as a percentage of income—Federal excises

[Thousands of dollars]

	Under 1	1 to 2	2 to 3	3 to 4	4 to 5	5.75	7.5 and over	Total
Total, including tobacco and liquor.	5.6	4.9	4.5	4.6	4.0	3.8	2.5	3.8
Total, excluding tobacco and liquor.	3.7	2.4	2.2	2.3	2.2	2.1	1.4	2.0

The lowest bracket of "under $1,000" shows regression but the composition and character of this group lessens the significance of sharp deviations from the general-burden pattern. This is particularly pertinent in this instance because the regressivity is caused almost entirely by Musgrave's resort to a general consumption pattern for allocating $2.2 billion of the total $4.4 billion 1948 Federal excise collections, exclusive of alcoholic beverages and tobacco products. At this juncture, such technique falls largely in the realm of conjecture. It exemplifies the need for precision instruments rather than hand-made tools.

THE EFFECT OF THE NATIONAL COMMITTEE FOR FAIR EMERGENCY EXCISE TAXATION PROPOSAL ON BURDEN

The foregoing discussions high lighted the impact of excise taxes on various income classes and pointed out the numerous difficulties involved in such measurement. The very fact that these excises, as they exist today, are imposed at various levels of the process of production, complicates the problem of uncovering the groups who really pay them. Since a large proportion are levied at the manufacturers' level, and since much is pyramided all along the way, in those instances where the final consumer does bear the burden of the tax, he pays far more heavily than had the same tax been imposed on him at the retail level. A study of the true burden of current excises should obviously take account of pyramiding.

Thus, were the same excises as are in effect today all levied at the retail level, the consumer would pay less than he pays today. To the extent that these commodities are purchased by the lower-income groups, their burden would be reduced. The change from a manufacturers' excise to an equivalent "retail"—point of final consumption—tax even on the presently taxed items, would return to the Government at a lower tax rate as much as it derives now and save the consumer considerable money. The Treasury Department estimated that in many industries a 10-percent tax at the manufacturers' level, would get as much revenue as a 6-percent tax at retail, where the retail price included the tax and took no account of pyramiding. In other industries an even sharper drop could be made because of the mark-up practices of the industry and the distribution channel common to the industry. Thus a product which travels from the manufacturer to the wholesaler to the retailer would have the tax marked up at both levels; one that was sold directly by the manufacturers to the retailer has the tax marked up only once.

The extension of excises to all retail sales or to all sales to the final consumer, as proposed by our NCFEET, would substantitally increase the tax base and still not increase the burden on the lower-income classes. As can be seen from a table submitted to Congressman Curtis (p. 1842, House hearings, 1951) the tax base would be more than doubled or tripled. The tax would not, of course, extend to food, rent, or medicine or to the traditionally excepted items. But by such an extension of the tax base, the same revenue as now obtained could be collected at much lower rates. Food, which takes the largest proportion of expenditures in the budget of the lower-income classes (those under $3,000), would be exempt. This means that approximately 35 percent of expenditures would automatically be exempt. An additional 15 to 20 percent would be excluded by the exemption of rent, approximately another 5 percent for drugs and medicines, and the exemption of traditionally excepted services means that at least 55 to 60 percent of the total expenditures of these lower-income groups would be free of retail taxation.

Conversely, it appears that the burden on the higher-income classes would tend to increase as a result of the application of this type of tax, since recent miscellaneous studies of consumer expenditures indicate that the main categories of expenditures that would be subject to the retail tax have a tendency toward progression—that is, expenditures as a percent of income increase as income increases.

Sincerely yours,

LEON HENDERSON

Mr. HENDERSON. One other item Mr. Stam and I had a little bit of disagreement on; if I can check for 1 minute, I think that we can correct that.

The estimate of the present law, I think, for 1952 is about 8.3 billion for fiscal 1952 from all——

Mr. STAM. I think, Mr. Henderson, on the excises, if you are just looking at the fiscal year 1952, the estimate of the additional revenue from excise is about $1,037,000,000, which makes your figure about right, the 500 instead of the 300, you see?

Mr. HENDERSON. But in our Curtis estimate we estimated that 10.5 billion, which is 2 billion more than the present law, so if you pick up a billion, then ours is, roughly, a billion.

I will give you my computation. I think that is correct.

Mr. STAM. I do not think there is any disagreement on this particular point.

Mr. HENDERSON. It would be upward of a billion, but the question then comes, Is it worth while changing the whole tax structure?

Senator BYRD. Thank you very much, Mr. Henderson. The attachments to Mr. Ruthenburg's statement will be placed in the record at this point.

(The documents referred to follow:)

DISCRIMINATION BY GENERAL CATEGORIES

Consumer durables

TAXED OR PROPOSED TO BE TAXED	NOT TAXED
Automobiles	Used automobiles
Trucks and busses	Used trucks and busses
Parts and accessories	Used parts and accessories
Tires and tubes	Other rubber products (hot water bags; rubber heels)
Business and store machines	Cash registers
Gas and electric appliances: Electric direct motor-driven fans and air circulators; electric, gas, or oil water heaters; electric flat-irons; electric air heaters (not including furnaces); electric immersion heaters; electric heating pads (exempted by H. R. 4473) and blankets; electric, gas, or oil stoves, warmers, coffee makers, ranges, roasters, toasters, waffle irons, hot plates, griddles, casseroles, steam tables, etc. (Proposed by H. R. 4473: power lawn mowers, gas or electric clothes driers, belt driven fans, dehumidifiers, dishwashers, door-bell chimes, food choppers and meat grinders, hedge clippers, ice cream freezers, electric sheets and spreads, shavers, floor polishers and waxers, pants pressers, mangles, and motion or still picture projectors.)	Gas and electric appliances: Blowers, vacuum cleaners, washing machines, sewing machines, hair dryers. Household furniture and furnishings, floor covering, draperies, light fixtures, etc. Furnishings include china, glassware, utensils, comforters, quilts, pillows, pottery, shears, portable lamps, lawn mowers, garden tools, etc. Also curtains, tablecloths, sheets, slipcovers, brooms, shower-bath curtains, towels, draperies, bedspreads, blankets.)
Mechanical refrigerators or quick freezes for household use.	Mechanical refrigerators or quick-freezes not for household use. Ice boxes.
Self-contained air conditioning units.	Air conditioning, not self-contained.

Personal appearance

Jewelry and watches	Clothing
Handbags	Accessories
Luggage	Shoes
Some toilet articles and preparations	Other toilet articles and preparations
Fur coats	Other coats
Some fur coats	Other fur coats

Services

Transportation [1]	Barber shops
Persons [1]	Beauty parlors
Property [1]	Laundries
Communications [2]	Classified advertising
Safe deposit boxes	Cleaning, dyeing and pressing
Household utilities	Household cleaning and repairs
(*a*) Electricity	Automobile storage, repair, rental
(*b*) Telephone	Dressmakers
	Household utilities
	(*a*) Gas
	(*b*) Water
	Shoe repair
	Hotel rooms and tourist cabins
	Upholstery and furniture repair
	Professional services
	Rug and drapery cleaning and repair
	Meals

Recreation

Admissions	Parimutuel wagering
Golf green fees	Golf instruction and caddy fees
Dues in athletic and social clubs	Dues in fraternal, business, patriotic, and women's clubs
Toys that look like musical instruments	Toys, bicycles, etc.
Radios	Radio programs
Televisions	Television programs
Photographic equipment	Photographic studios, developing and printing
Musical instruments and records	Books and magazines, and circulating libraries

Personal habits

Liquor, wine, and beer	Soft drinks
Cigarettes and tobacco	Candy and ice cream
Entertainment in cabaret	Entertainment in private club

Miscellaneous

Photographic lenses	Eyeglass lenses
Beads (strung)	Beads (unstrung)
Seat covers	Custom-made seat covers
	Building materials

NATIONAL COMMITTEE FOR FAIR EMERGENCY EXCISE TAXATION, NEW YORK, N. Y.

Officers:

Chairman: Louis Ruthenburg, chairman of the board, of Servel, Inc.

Vice chairmen:

Ardé Bulova, chairman of the board, of Bulova Watch Co.

J. H. Carmichael, president, Capital Airlines, Inc.

John A. Robertshaw, president, Robertshaw-Fulton Controls Co.

Robert C. Tait, president, Stromberg-Carlson Co.

Treasurer: Charles T. Lawson, vice president, Nash-Kelvinator Corp.

Secretary: H. Leigh Whitelaw, managing director, Gas Appliance Manufacturers Association, Inc.

[1] Transportation has its own discriminatory features, thus: Public transportations is taxable, private is not; travel by intercity bus, plane, train, or ship is taxable, by taxicab or rented car, plane, or boat is not; a flat rate in freight tax discriminates against the long haul as against the short haul. Commutation tickets exempt.

[2] There are also discriminations within the communications taxes, i. e., a domestic telegraphic message is taxed at 25 percent (20 percent under H. R. 4473); international at 10 percent. If I call Paris collect from New York, I pay no tax. If I call New York collect from Paris I pay a tax.

General counsel: Wilson W. Wyatt, Wyatt, Grafton & Grafton.
Committee on procedures:
Chairman: Glen McDaniel, vice president, Radio Corp. of America.
Members:
J. Carlton Bagnall, president, Swank, Inc.
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Clarence Coleman, vice president, the Coleman Co., Inc.
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Robert Driscoll, vice president, the Greyhound Corp.
M. P. Duke, president, Duke Manufacturing Co.
C. W. Engelhard, president, Engelhard Industries.
D. H. Farrington, executive vice president, Farrington Manufacturing Co.
Albert J. Feldman, treasurer, A. Hollander & Son, Inc.
Bruce A. Fleming, vice president, Edwin L. Weigand Co.
Marion B. Folsom, treasurer, Eastman Kodak Co.
Charles J. Gibson, president, Gibson Refrigerating Co.
Julius Green, president, Julius Green Fur Co., Inc.
H. E. Handley, president, Handley Brown Heater Co.
Lyle C. Harvey, president, Affiliated Gas Equipment Corp.
Oscar Heyman, president, Oscar Heyman & Bros., Inc.
Richard A. Hinckley, vice president, General Water Heater Corp.
Stanley H. Hobson, president, Geo. D. Roper Corp.
F. A. Holme, assistant to the chairman, General Electric Co.
Henry Honer, president, Western Stove Co., Inc.
John S. Kier, executive vice president, Dennison Manufacturing Co.
Julius Klein, president, Caloric Stove Corp.
T. J. Lawes, assistant to president, Proctor Electric Co.
Paul Levinger, vice president, Speidel Corp.
R. H. Lewis, president, Ruud Manufacturing Co.
A. W. McGregor, president, Robbins & Myers, Inc.
L. R. Mendelson, president, the Hotstream Heater Co.
Don G. Mitchell, president, Sylvania Electric Products, Inc.
Robert F. Patrick, president, G. S. Blodgett Co., Inc.
W. A. Patterson, president, United Air Lines
Ray A. Polverini, vice president, Pioneer Water Heater Corp.
W. T. Rasch, president, Security Manufacturing Co.
Carl P. Ray, assistant to the president, Underwood Corp.
A. B. Ritzenthaler, vice president, the Tappan Stove Co.
Willard F. Rockwell, chairman of the board, Rockwell Manufacturing Co.
Gerald E. Rosenberger, president, Coro, Inc.
Lee Shubert, vice president, the League of New York Theaters, Inc.
R. D. Siragusa, chairman and president, Admiral Corp.
E. C. Stephenson, vice president of finance, the J. L. Hudson Co.
Arthur Stockstrom, president, American Stove Co.
A. H. Sutton, president, Mission Appliance Corp.
George Umbreit, executive vice president, the Maytag Co.
E. C. Vawter, general manager, Hoyt Heater Co.
W. H. Wheeler, Jr., president, Pitney-Bowes, Inc.
R. L. White, president, Landers, Frary & Clark
H. V. Widdoes, vice president, Remington Rand, Inc.
Harry Winston, Harry Winston, Inc.

GOODS AND SERVICES INCLUDED AND EXCLUDED IN TAX BASE OF $111,640,000,000 USED BY LEON HENDERSON FOR ESTIMATE OF REVENUE FROM 5 PERCENT RETAIL SALES TAX

[(s)=service, (dc)=durable commodity, (ndc)=nondurable commodity]

INCLUDED

I. Food and tobacco

Purchased meals and beverages (ndc):
 Retail, service, and amusement establishments (ndc)
 Hotels
 Dining and buffet cars
 Clubs
Tobacco products and smoking supplies
Alcoholic beverages

II. Clothing, accessories, and jewelry

Shoes and other footwear (ndc)
Shoe cleaning and repair (s)
Clothing and accessories except footwear (ndc)
Fur storage and repair (s)
Cleaning, dyeing, pressing, alteration, storage, and repair of garments, n. e. c. (in shops) (s)
Dressmakers and seamstresses (not in shops) (s)
Costume and dress-suit rental (s)
Net purchases from second-hand clothing dealers (s)
Miscellaneous personal services (s)
Jewelry and watches (dc)
Watch, clock, and jewelry repair (s)

III. Personal Care

Toilet articles and preparations (ndc)
Barber-shop services (s)
Beauty-parlor services (s)
Baths and masseurs (s)

IV. Housing

Transient hotels and tourist cabins

EXCLUDED

I. Food and tobacco

Food purchased for off-premise consumption (ndc)
Purchased meals:
 Schools and school fraternities (ndc)
 Institutions and industrial lunchrooms
 Food furnished government (including military) and commercial employees, and withdrawn by nonfarm proprietors (ndc)
 Food produced and consumed on farms

II. Clothing, accessories, and jewelry

Standard clothing issued to military personnel

III. Personal care

IV. Housing

Owner-occupied nonfarm dwelling space, rental value (s)
Tenant-occupied nonfarm dwellings (including lodging houses), space rent (s)
Rental value of farm houses (s)
Clubs, schools, and institutions

V. Household operation

Furniture (dc)
Floor coverings (dc)
Refrigerators and washing and sewing machines (dc)
Miscellaneous electrical appliances except radios (dc)
Cooking and portable heating equipment (dc)
Durable house furnishings, n. e. c. (dc)
Products of custom establishments, n. e. c. (dc)
Writing equipment (dc)
Net purchases from second-hand furniture and antique dealers (s)
Upholstery and furniture repair (s)
Rug, drapery, and mattress cleaning and repair (s)
Care of electrical equipment except radios and of stoves
Semidurable house furnishings (ndc)
Lighting supplies (ndc)
Cleaning and polishing preparations (ndc)
Miscellaneous household paper products (ndc)
Stationery and writing supplies (ndc)
Fuel (except gas) and ice purchased (ndc)
Household utilities:
  Electricity (s)
  Gas (s)
  Water (s)
Telephone (s)
Telegraph, cable, and wireless (s)
Express charges (s)
Moving expenses and warehousing (s)
Miscellaneous household operation services (s)

V. Household operation

Fuel (except gas and ice) produced and consumed on farms (ndc)
Postage (s)
Domestic service (excluding practical nurses)
Fire and theft insurance on personal property, net payments

VI. Medical care and death expenses

VI. Medical care and death expenses

Drug preparations and sundries (ndc)
Ophthalmic products and orthopedic appliances (dc)
Physicians (s)
Dentists (s)
Osteopathic physicians (s)
Chiropractors (s)
Chiropodists and podiatrists (s)
Private-duty trained nurses (s)
Practical nurses and midwives (s)
Miscellaneous curative and healing professions
Privately controlled hospitals and sanitariums (s)
Net payments to group hospitalization and health associations (s)
Student fees for medical care (s)
Accident and health insurance, net payments (s)
Mutual accident and sick benefit associations, net payments (s)
Funeral and burial services (s)
Cemeteries and crematories (s)
Monuments and tombstones (dc)

VII. Personal business

Miners' expenditures for explosives, lamps, and smithing (ndc)
Tools (do)
Safety-deposit-box rental (s)
Classified advertisements (s)
Net purchases from pawnbrokers and miscellaneous second-hand stores (s)

VII. Personal business

Theatrical employment agency fees (s)
Nontheatrical employment agency fees (s)
Net payments to labor unions (s)
Employees' dues and fees to professional associations (s)
Brokerage charges and interest and investment counseling (s)
Trust services of banks (s)
Bank service charges for deposit accounts, check collections, and foreign exchange (s)
Money-order fees (s)
Services furnished without payment by financial intermediaries except insurance companies (s)
Expenses of handling life insurance, life-insurance companies and fraternal and assessments associations (s)
Legal services
Interest on personal debt
Personal business services, n. e. c. (s)—notary public, detective, etc.

VIII. Transportation

User-operated transportation:
- New cars (dc)
- Used cars (dc)
- Tires and tubes (dc)
- Parts and accessories (dc)
- Automobile repair, greasing, washing, parking, storage, and rental (s)
- Gasoline and oil (ndc)
- Bridge, tunnel, ferry, and road tolls (s)
- Automobile insurance, net payments

Purchased intercity transportation:
- Steam railway (excluding commutation) (s)
- Sleeping and parlor car, fares and tips (s)
- Intercity bus (s)
- Airline (s)
- Coastal and inland waterway (s)
- Baggage transfer, carriage, storage, and excess charges (s)
- Luggage (dc)

VIII. Transportation

IX. Recreation

Admissions to specified amusements:
- Motion-picture theaters (s)
- Legitimate theaters and opera (s)
- Entertainment of nonprofit organizations, except athletics (s)
- Professional baseball (s)
- Professional football (s)
- Professional hockey
- Horse and dog race tracks (s)
- College football (s)
- Other amateur spectator sports (s)
- Ticket brokers' mark-up on admissions (s)
- Purchase of programs (s)

Parimutuel net receipts (s)

Nonvending coin machines, receipts minus pay-off (s)

Specified commercial participant amusements:
- Billiard parlors and bowling alleys (s)
- Dancing, riding, shooting, skating, and swimming places (s)
- Amusement devices and parks (s)
- Daily fee golf courses, green fees (s)
- Golf instruction, club rental, and caddy fees (s)
- Sightseeing busses and guides (s)
- Private flying operations (s)

Informal recreation:
- Books and maps (dc)
- Magazines, newspapers, and sheet music (ndc)
- Book rental and repair
- Nondurable toys and sport supplies (ndc)
- Wheel goods, durable toys, and sport equipment (dc)
- Boats and pleasure aircraft (dc)
- Boat and bicycle rental, storage, and repair (s)
- Radios, phonographs, parts, and records (dc)
- Pianos and other musical instruments (dc)
- Radio repair (s)
- Photo developing and printing (s)
- Photographic studios (s)
- Collectors' net acquisition of stamps and coins (s)
- Hunting dog purchase and training, and sports guide service (s)
- Veterinary service and purchase of pets (s)
- Flowers, seeds, and potted plants (ndc)
- Clubs:
  - Athletic and social (s)
  - Luncheon
- Commercial amusements, n. e. c. (s)

IX. Recreation

Camp fees (s)

Clubs:
- School fraternities
- Fraternal, patriotic, and women's

X. Private education and research	*X. Private education and research*
	Higher education (s) Elementary and secondary schools (s) Commercial, business, and trade schools, fees (s) Correspondence schools, fees (s) Other instruction (except athletics) fees (s) Foundation expenditures for education and research (s)
XI. Religious and welfare activities	*XI. Religious and welfare activities*
	Religious bodies (s) Social welfare and foreign relief agencies (s) Museums and libraries (s) Foundation expenditures (except education and research) (s) Political organizations (s)
XII. Foreign travel and remittances	*XII. Foreign travel and remittances*
	Foreign travel and remittances by United States residents

XIII. Miscellaneous

Trucks and busses
Building materials
Farm implements
Hardware

Senator BYRD. The next witness is Mr. John Wicker, Jr.

Mr. Wicker is a very prominent member of the Virginia Bar, and has been for 25 years. He has been a member of the State Senate of Virginia; was president of the State electoral college in 1944; and was temporary chairman of the Constitutional Convention of Virginia in 1945.

STATEMENT OF JOHN J. WICKER, JR., AMERICAN MUTUAL ALLIANCE

Mr. WICKER. Thank you, Senator Byrd, for that generous comment. I appreciate it.

Mr. Chairman, and gentlemen, I am truly grateful for the opportunity to appear before you, and knowing how much you are pressed for time, I will take less than 3 minutes.

I have a prepared statement here which I am not going to read, but which I believe fully answers and refutes the misrepresentations that have been made to you by representatives of a notorious propaganda association calling itself the National Tax Equality Association, which misrepresentations were intended to convey the utterly erroneous impression that mutual fire and casualty companies are either tax-exempt or are not bearing their full share of the tax burden.

Both sides of this question were fully heard and considered by the Ways and Means Committee, and that committee agreed with these mutuals, and refused to recommend any change in the existing mutual insurance tax laws, which have proven satisfactory for the past 9 years to the Treasury Department.

Instead of recommending any changes at this time, the Ways and Means Committee directed the staff of your own Joint Committee on

Internal Revenue Taxation, together with the Treasury, to make a thorough and impartial study of the taxation of all types of fire and casualty insurance companies, and this study should be completed in a few months hence.

If it were not for this special study we would have desired a full hearing, and I believe that we could have convinced you, as we did the Ways and Means Committee, that mutual fire and casualty insurance companies are already fully and fairly taxed.

However, since we feel your committee would not care to consider this involved and controversial subject until after you have had the benefit of your special study by your own staff, we are merely presenting our own statement with the attached exhibits, and ask that it be received as a part of the record of these hearings.

If, perhaps, any member of this committee has any doubt in the meantime, we believe that a reading of our statement, and the exhibits therewith, will remove that doubt.

In closing, Mr. Chairman, I want to leave with you a photostatic copy of a proposed advertisement which contains a libelous attack upon this committee and upon the Congress as a whole.

This proposed advertisement was very recently, July 20, sent out all over this country, with the suggestion that it be published locally in August.

It was sent out by the National Tax Equality Association, and in sending it out, as you will see from their transmittal letter, they said it could be published over their name or over a fictitious name that they suggested.

This is nothing less, as you will see, than a brazen attempt to undermine the confidence of the American people in the honor and integrity of their duly-elected representatives.

Thank you.

Senator MILLIKIN. What, may I ask, do you desire of this committee?

Mr. WICKER. As we have indicated here, we believe, Senator Millikin, that the logical course is for the committee to defer consideration of this involved subject until you have the benefit of the study before you, and we will have an opportunity to discuss it—the study of your own joint committee staff and the Treasury Department, and then we think you can make an intelligent decision.

Senator MILLIKIN. As I understand it, the House requested that kind of a study, and I assume that some kind of a study of that kind is under way?

Mr. WICKER. Yes, sir.

Senator MILLIKIN. Thank you, sir.

(The prepared statement of Mr. Wicker together with the exhibits follow:)

REPLY TO ATTACKS ON THE TAX STATUS OF MUTUAL FIRE AND CASUALTY INSURANCE COMPANIES

(Statement submitted on behalf of American Mutual Alliance)

INTRODUCTION

My name is John J. Wicker, Jr. I am a lawyer with offices in Richmond, Va. The experience I gained while serving on the finance committee in the Senate of Virginia enables me to appreciate the perplexing problems of any legislative committee dealing with taxation. I am appearing here today on behalf of American

Mutual Alliance, which is an association of mutual fire-insurance companies and mutual casualty insurance companies with its headquarters in Chicago, Ill. Its members write a substantial part of the fire and casualty insurance risks insured by mutual insurance companies in the United States. While I speak as counsel only for these companies which write a substantial portion of the business, material presented applies to mutual fire and casualty insurance generally.

Inasmuch as no official proposals are before your committee, to our knowledge, for any change in the law under which mutual fire and casualty insurance companies (which I will refer to hereafter as these mutuals) have been paying very substantial Federal income taxes each and every year since 1942, perhaps it may appear unusual or even unnecessary to discuss their Federal income-tax status.

After considering arguments on both sides of the matter, in its recent hearings, the House Ways and Means Committee decided against making any change at this time. The House committee directed that the staff of your Joint Committee on Internal Revenue, together with the Treasury Department staff, make a special study of the Federal tax status of fire and casualty insurance of all types—mutual, stock, reciprocal, etc. The mutual fire and casualty insurance companies promptly offered their complete cooperation to the joint committee staff and to the Treasury staff in this study. On the other hand, NTEA and other antimutual propagandists have appeared before your committee and urged premature action, before this study can be completed.

ATTACKS ON MUTUAL TAX STATUS ARE INSPIRED BY VICIOUS ANTIMUTUAL PROPAGANDA CAMPAIGN

Unfortunately, some vicious attacks have been made upon the tax status of these mutuals. There have been many misrepresentations and distortions of fact, not only before your committee but also by circulars and publications, as part of a Nation-wide campaign designed to flood the Congress and the general public with antimutual proganda.

Its obvious purposes are—

(1) To undermine the confidence of the American people in mutual insurance, in an effort to cripple the mutuals, and to weaken, if not destroy, the wholesome competition now existing between the mutuals and the stock insurance companies. This campaign involves such devises as insinuating that those who become mutual insurance policyholders are helping to advance the cause of communism and socialism, etc.

(2) To high-pressure Congress into ignoring the fundamental differences between these mutuals and the stock companies in the hope that these mutuals will be saddled with an unfair tax burden, and with the further hope that the present exemption of the very small mutual insurance companies will be wiped out.

Unless these misrepresentations are publicly answered and refuted, the public may be left under the false impression that the Congress and the Treasury Department have granted, and are permitting to continue, some sort of unfair tax preference for these mutuals. Accordingly we are making this statement.

MUTUALS PAID OVER $80,000,000 FEDERAL INCOME TAXES, 1942–50

The fact that mutual fire and casualty insurance companies have been paying substantial Federal income taxes since the enactment of the present mutual tax provision in 1942 is attested by the following tabulation:

1942	$5,125,000	1948	$11,237,000
1943	5,859,000	1949	12,816,000
1944	6,893,000	1950	13,851,000
1945	7,622,000		
1946	8,596,000	Total	80,803,000
1947	9,804,000		

These figures represent the Federal income taxes incurred by mutual fire and casualty insurance companies as shown by Best's Insurance Reports for 1942; Best's Aggregates and Averages 1943–49 and for 1950 by Best's Insurance Guide (1951 edition).

As shown above, during the period of the present mutual tax formula (1942–50, both inclusive) the Federal income taxes incurred by these mutuals have aggregated more than $80,000,000; have been substantial each and every year; have steadily increased each year; so that for the year 1950, alone, the tax incurred by these mutuals aggregated more than $18,000,000.

THE MUTUAL INSURANCE PREMIUM DOLLAR ACTUALLY PRODUCES GREATER FEDERAL REVENUE

But even this total of more than $80,000,000 constitutes only a portion of the income-tax revenue which the Federal Government derives as a result of the operations of mutual fire and casualty insurance companies. A much larger amount is paid in Federal income taxes by commercial policyholders as a result of dividend refunds made to them by these mutuals.

During the 9-year period, 1942 to 1950 inclusive, on the basis of the most complete data available, these mutuals saved for their millions of policyholders and refunded in cash to those policyholders, the very substantial sum of $1,144,407,000. It is conservatively estimated that about 80 percent of the fire and casualty insurance premiums come from commercial policyholders, rather than nonbusiness sources. Accordingly, when these savings are returned to business policyholders, they become fully taxable to those business policyholders, as a reduction in their cost of doing business.

When the Federal income taxes incurred by these mutual business policyholders on these premiums returned as savings are added to the Federal income taxes paid by the mutual fire and casualty insurance companies themselves, it can be seen at a glance that the mutual-insurance dollar is producing greater revenue for the Federal Government than the stock-insurance dollar. Included as exhibits herewith, are two statistical charts which very clearly illustrate the fact that, under the existing tax formulas, the Federal Government has derived proportionately more in taxes from mutual fire and casualty insurance than from stock insurance. Best's Insurance Guide (1951 edition) reveals the interesting fact that the majority of stock fire and casualty companies, accounting for a substantial volume of their total business, incurred no Federal income-tax whatever for one or more years during the last 5 years.

MORE THAN 97 PERCENT OF MUTUAL INSURANCE BUSINESS PAYS SUBSTANTIAL INCOME TAXES EVERY YEAR—ONLY SMALL MUTUALS, DOING LESS THAN 3 PERCENT OF THE BUSINESS, ARE TAX-EXEMPT

It frequently is charged that "80 percent of all mutuals are exempt from taxation." This is a half-truth of the sort more misleading than an absolute falsehood.

It is true that many small mutual companies (usually local farm mutuals) are tax-exempt and that they aggregate about 78 percent of the number of all mutual fire and casualty insurance companies. However, it also is true that the premiums written by all of these small companies combined account for less than three percent of the total volume of mutual fire and casualty insurance premiums written. Conversely, the mutual companies writing more than 97 percent of the total volume of mutual fire and casualty insurance business are not tax-exempt, but on the contrary have been subject to substantial Federal income taxes in each year since 1942. Thus, even though 78 percent of the number of mutual companies may be exempt, 97 percent of the mutual premium volume is taxed—and taxed substantially.

The only mutuals exempt from income taxes are those whose gross receipts (from premiums, assessments, investment earnings, and other income, without any deductions for expenses or losses) do not exceed $75,000 per year. In fact, the average gross income of these small mutuals from all sources (in 1948) was less than $18,000 per year. Often total receipts of these small mutuals merely represent the total of the losses for which the policyholders have assessed themselves, and they usually have little or no investment income.

When the mutual tax formula was developed by the Congress in 1942, the Treasury Department, the staff of the Joint Committee on Internal Revenue, the Senate Finance Committee, and the House Ways and Means Committee were all of the opinion that these small mutuals should continue to be exempt from Federal income taxes. The tax-exempt status of these very small mutuals is analogous the tax-exempt status of millions of individual citizens whose gross income is so small that no income tax is imposed upon them.

FUNDAMENTAL DIFFERENCES BETWEEN STOCK AND MUTUAL INSURANCE

Certain basic facts must be kept in mind before an evaluation can be made of the relative tax positions of the mutuals on the one hand, and of the stock companies on the other hand.

There are several important fundamental differences between mutual and stock insurance companies. The mutual is a nonprofit organization, designed and operated on behalf of its policyholders to provide insurance protection at the lowest reasonable net cost. In contrast, the stock insurance company is designed primarily—and quite properly so—to produce profits for its third-party owners, the stockholders, while providing insurance protection for its policyholders.

Mutual insurance companies and stock companies are chartered and regulated under State insurance laws. Unlike the stock companies, mutual companies have no stockholder-owners. Anyone obtaining a policy of mutual insurance becomes thereby a member of a mutual insurance company, and is carried individually by name on the mutual company's membership rolls. He cannot secure a policy of mutual insurance without becoming a member; he cannot become a member in any other way.

Mutual policyholder-members generally are the only ones who have the legal right to control mutual companies through the election of directors. In stock companies, the policyholders have no voice or control in the management, or in the election of directors, since these powers are vested entirely in the third-party stockholder-owners.

In both stocks and mutuals, the funds which are collected as insurance premiums and derived from investments, are used first for the payment of losses and expenses, and to set up such reserves as may be required by law or by good business judgment for the safe operation of the company.

In mutual companies, funds not required for these purposes are returned to the policyholders. These refunds are paid in cash, unless the policyholder desires to apply them in payment for new insurance.

In stock companies, on the other hand, funds not required for such purposes may be paid to the stockholders as dividends at any time the directors choose; or such funds may be retained in the company, thereby enhancing its net worth and usually enhancing the market value of its stock.

In a mutual insurance company there are no "profits," and there never are any third-party owner interests. The assets of a mutual insurance company remain at all times the property of its policyholders. In case of liquidation of a stock insurance company all surplus assets belong to the third-party stockholders, and the policyholders have no right to any part of such surplus assets. On the other hand, in case of liquidation of a mutual company, all of its surplus assets belong to the policyholders.

RECOGNIZING THESE FUNDAMENTAL DIFFERENCES, CONGRESS HAS DEVISED DIFFERENT TAX PLANS

The Congress always has recognized the important fundamental differences between stock and mutual insurance, and in consequence has devised different plans for taxing the two different types of insurance companies, just as it has devised different plans for taxing many other types of business corporations.

Stock fire and casualty insurance companies pay Federal income taxes at regular corporation rates upon the gains they make for the account of their stockholders in all income transactions with third parties; these are the gains growing out of insurance transactions with their policyholders, and the gains growing out of investment transactions.

Mutual fire and casualty insurance companies have no stockholders. They pay Federal income taxes at regular corporation rates upon the gains they make for the account of their policyholders in all income transactions with third parties; these are the gains growing out of investment transactions. No gains for the account of policyholders of a mutual insurance company can grow out of insurance transactions with policyholders; the two groups are identical.

In 1942, after the Treasury Department and the staff of the Joint Committee on Internal Revenue had given long and careful study to the subject of insurance taxation, the Congress—then, as now, facing emergency wartime revenue demands—adopted a tax plan for mutual fire and casualty insurance companies. Under this plan, found in section 207 of the Internal Revenue Code, each of these mutuals must pay each and every year—

Either a tax at regular corporation rates on its entire net investment income (net income from interest, dividends, rents, and net capital gains);

Or a tax of 1 percent of the total of its gross income from interest, dividends, rents, and of its gross premiums (less return premiums, premiums paid for reinsurance, and dividend refunds to policyholders).

MUTUALS HAVE A "TAX FLOOR" PRODUCING SUBSTANTIAL TAXES EVERY YEAR

The mutuals must compute the tax by both methods, and must pay the larger of the two taxes.

Consequently, these mutuals have a substantial income tax floor. Neither the stock insurance companies nor any other substantial group of taxpayers has any such income tax floor. Every increase in the corporate tax rates, as applied to ordinary business corporations, is applicable to the investment income of the mutuals. Thus, when corporate tax rates rise, the dollar amount of tax paid on their investment income increases. Ever since 1942, this mutual tax plan has produced a steady and substantial flow of tax revenue for the Federal Government without regard to whether mutual insurance operating experience was good or bad.

On the other hand, the stock insurance company is taxed only on its net profits, after it has first deducted all losses and operating expenses and any dividends to policyholders. Thus when a stock insurance company's profits are high, its Federal income taxes rise; when its profits are low, its Federal income taxes decline; when it incurs a net loss for the year, a stock insurance company incurs no Federal income tax.

The effect of the present different tax formulas on stock and mutual fire and casualty insurance companies is shown by a study of Federal income taxes incurred in 1949 by 475 stock companies and 313 mutual companies, and the taxes incurred in 1950 by identically the same lists of companies. The figures are shown in Best's Insurance Reports and Best's Insurance Guide.

The net premium volume of these 475 stock companies increased 9 percent in 1950, as compared to 1949, but their Federal income taxes incurred decreased 25 percent.

The net premium volume of these 313 mutual companies increased 8⅔ percent and their taxes increased more than 13 percent.

ANTIMUTUAL PROPAGANDA VARIES AS STOCK INSURANCE PROFITS VARY

These wide variations in the year-to-year amounts of Federal income taxes paid by stock insurance companies have somewhat the result which would be expected. When stock insurance taxes increase, there are loud complaints about Federal income-tax discrimination; when stock insurance taxes are low, then the complaints quiet down. Hostile propaganda against the Federal income-tax position of the mutuals has gone into high gear in 1949 and 1950, following years in which many stock insurance companies made profits which—while they were entirely legitimate—were greater than any in their previous histories. Years like 1946 and 1947—when mutual taxes were relatively higher than those of stock, fire, and casualty insurance companies—were years when the antimutual propagandists spoke only in whispers.

ANTIMUTUAL STATEMENTS AND STATISTICS ARE UNFAIR, DISTORTED AND MISLEADING

On July 19, Prof. O. Glenn Saxon, appeared before your committee on behalf of the NTEA. He presented as his own, almost word for word, the antimutual statement presented to the Ways and Means Committee last February by Mr. William E. Webb, Jr., a stock insurance agent. The Webb statement, in turn, had been taken largely from the statement filed with both of the congressional tax-writing committees in 1950 by the National Tax Equality Association—the notorious propaganda organization which raises hundreds of thousands of dollars each year for use in attempting to high-pressure Congress into following the partisan tax recommendations.

It is not clear whether Professor Saxon was offering his own conclusions as a serious economics scholar, or was merely serving as an advocate for the NTEA's standard arguments.

A part of these presentations consisted of statistics which have been relied upon and quoted from by several other witnesses speaking on behalf of the NTEA. Although these raw statistics were taken from the authoritative Best's Fire and

Casualty Aggregates and Averages, their use in these witnesses' attempted analysis of Federal tax principles is very unfair and misleading in several important particulars.

(1) They completely ignored the factor of refunds to policyholders (although for mutual companies these refunds aggregated $842,422,652 for 1943–49). This device seriously distorted the significance of the statistics.

(2) They included in the data concerning mutuals figures based on the health and accident premiums of certain substantial mutual companies, which may be taxed on a very different basis. This constituted a further distortion.

(3) They ignored the very substantial income taxes incurred by commercial policyholders on approximately 80 percent of the mutual policyholder refunds, the inclusion of which would have shown that the mutual premium dollar produces even more Federal tax revenue than the stock premium dollar.

DIFFERENCES IN TAXES OR PERCENTAGES DO NOT NECESSARILY INDICATE TAX INEQUALITY OF UNFAIR DISCRIMINATION

However, even on the basis of the NTEA-Webb-Saxon statistics, unfair as they are to the mutuals, it should be apparent that differences in amount or percentages of taxes do not necessarily indicate any sort of tax inequality or unfair discrimination.

For example, the NTEA-Webb-Saxon statistics reveal the following amazing tax differences between the stock fire companies and the stock casualty companies:

(1) For the period 1943–49, inclusive: The stock fire companies incurred taxes averaging only 16.8 percent of their total profits, which was nearly one-fourth less than the 21.5 percent incurred by the stock casualty companies. Yet during this entire period stock fire companies and stock casualty companies were governed by identically the same tax law (sec. 204, Internal Revenue Code).

(2) Furthermore, for the year 1945 the taxes of the stock casualties companies, in relation to profits, were nearly twice as large as those of the stock fire companies, as shown by the following tabulation.

	Earned premiums	Total profits	Federal income taxes incurred	Tax as percent of total profits
Stock fire companies	$1,128,133,000	$328,089,000	$16,313,000	5.0
Stock casualty companies	1,127,884,000	222,151,000	21,472,000	9.7

Consequently, when such substantial tax differences between different groups of stock companies, under the same section of the tax law, are not regarded as evidence of tax discrimination or tax inequality, no one can reasonably argue that tax differences between stock companies on the one hand and mutual companies on the other hand are any evidence of tax inequality or unfair discrimination.

IDENTICAL TAX PLANS ARE NOT REQUIRED BETWEEN ALL COMPETITORS

Three competing merchants, in the same line of business and with similar locations and business volumes, may pay income taxes which differ vastly in amounts, percentages of volume, and percentages of profit. One operates as a sole proprietor, one as a partnership, another as a corporation. Yet these differences in taxes of competitors are not regarded as tax inequalities, because of the fundamental differences in the nature and operation of the three competitors. Similarly, even though stock and mutual insurance companies are competing in the same lines of business, they are fundamentally different in character, ownership, purpose, and so forth. Consequently, it is only natural and proper that they should have different tax plans which may develop varying differences in taxes from time to time.

NTEA ATTEMPTED ANALOGY BETWEEN LIFE INSURANCE TAXATION AND FIRE AND CASUALTY INSURANCE TAXATION IS NOT SOUND

In his statement to this committee Professor Saxon undertook to argue that there is no legal or economic justification for taxing mutual fire and casualty insurance corporations on a gross-receipts basis while taxing their capital-stock competitors on net income as all other corporations are taxed. He indicated Federal income-tax provisions for mutual and stock fire and casualty insurance companies should be identical because provisions for taxing mutual and stock life insurance companies are identical.

The efforts of uninformed advocates to force sweeping changes in the laws governing one of the major economic institutions of this country—insurance—upon the basis of illogical and unsound comparisons of just this sort is the principal reason why there is congressional sentiment for a thoroughgoing study of the whole subject of insurance taxation by experts who understand the many complexities involved.

In the first place, mutual fire and casualty insurance companies are not taxed upon a gross-receipts basis; they are taxed at full corporation rates upon the only income they receive from outside sources—namely, investment income. The gross-receipts tax is merely a "floor" below which the tax on investment income is not permitted to fall. This is essentially the basis upon which life insurance companies now pay Federal income taxes, except that only a small portion of their investment income is considered taxable income, whereas the entire net investment income of mutual fire and casualty insurance companies is considered taxable income.

In the second place, the great bulk of life insurance, both stock and mutual, is written on the participating plan, by both types of companies. Consequently it is understandable that life insurance companies are taxed identically.

In the third place, it is assumed that there are important differences between life insurance and fire and casualty insurance which may have significant legal and economic bearings upon the Federal income-tax plans suitable for the different types of carriers. The fact that a life insurance policy may run for scores of years without possibility of a change in rate, and that each policy must at some time mature, is a situation very different from that existing in fire and casualty insurance, and makes it possible to determine with great accuracy how much each policy will cost the life insurance company. Life insurance policies are sold upon a basis which requires a certain amount of investment earnings; in fire and casualty insurance rates are made without giving any consideration to investment earnings.

It might be pointed out that, according to Professor Saxon's own figures covering the 1943–49 period, the actual dollar amount of Federal income taxes incurred by both stock and mutual fire and casualty insurance companies was exactly 25.2 percent of the dollar amount of the net investment gain of each type of carrier.

It might also be pointed out that Professor Saxon's contention that the present tax situation will lead to domination of the fire and casualty insurance business by mutual companies—as he says the life insurance business now is dominated—cannot be demonstrated historically. The mutual life insurance companies were writing most of the life insurance in this country long before there was a Federal income tax law, and the mutual life insurance companies have maintained their position under a system of so-called tax equality with stock life insurance companies.

ANTIMUTUAL PROPAGANDA, WHILE FALSELY PORTRAYING MUTUALS AS TAX SLACKERS, IGNORES FACT THAT MUTUALS IN SOME YEARS HAVE PAID HIGHER TAXES THAN STOCK COMPANIES

Some recent antimutual propaganda circulars actually claim that the mutuals are tax slackers—tax 4-F's—who did not pay their fair share of Federal income taxes during and since World War II. Such claims are viciously false, and they display a cynical disregard for the intelligence of Congress and of the public. Even the NTEA-Webb-Saxon statistics show that in 1944, 1946, and 1947, mutual fire companies as a group paid relatively higher Federal income taxes than stock fire companies, and also that in 1946 and 1947, the mutual casualty insurance companies as a group paid relatively higher taxes than the stock casualty companies.

The NTEA-Webb-Saxon statement attempted to explain away these higher mutual payments in some years by stating: "The only year in the 7-year period studied (1943–49) in which the fire-insurance business was close to normal was the year 1949." As a matter of fact, in 1949 the stock fire insurance companies' profits were so great that in that year alone they incurred as much in Federal income taxes as they had during the six previous years combined. Here is what the Alfred M. Best Co., Inc., the standard insurance statistical authority, says in its annual review as of the end of 1950:

"The year (1950) ranks among the best the fire companies have ever had and firmly establishes the last 3 years as the most profitable 3-year period in fire-insurance history."

MUTUALS SOMETIMES PAY MUCH HIGHER TAXES THAN STOCK COMPANIES

The following arbitrarily selected comparisons are taken from Best's Insurance Reports, covering the latest 5-year period 1946–50, inclusive:

	Net earned premiums [1]	Federal income taxes [2]
Massachusetts Bonding & Insurance Co. (Massachusetts) (stock casualty)	$132,900,000	−$228,000
Michigan Mutual Liability Co. (Michigan) (mutual casualty)	81,603,000	+791,000
Sun Indemnity Co. (New York) (stock casualty)	27,888,000	−45,000
Security Mutual Casualty Co. (Illinois) (mutual casualty)	20,313,000	+402,000
New York Casualty Co. (New York) (stock casualty)	37,208,000	−319,000
Iowa National Mutual Insurance Co. (Iowa) (mutual casualty)	38,200,000	+401,000
Louisville Fire & Marine Insurance Co. (Kentucky) (stock fire)	6,801,000	−73,000
Implement Dealers Mutual Fire Insurance Co. (North Dakota) (mutual fire)	6,580,000	+73,000
Hamilton Fire Insurance Co. (New York) (stock fire)	1,972,000	−1,000
Granite Mutual Insurance Co. (Vermont) (mutual fire)	1,114,000	+2,000
Dubuque Fire & Marine Insurance Co. (Iowa) (stock fire)	16,815,000	+1,000
Employers Mutual Fire Insurance Co. (Wisconsin) (mutual fire)	9,548,000	+103,000

[1] These "net-earned premiums" are stated before deduction of policyholder refunds-dividends.
[2] − indicates tax credit carry-over and no income tax incurred.

Anyone caring to use the same tactics employed by antimutual propagandists could cite the foregoing comparisons as proof that mutual companies pay relatively much higher Federal income taxes than stock companies do. They are not cited here for any such purpose but merely as glaring examples, exactly opposite, in appearance and effect, to the statistical comparisons cited by tax critics of the mutuals.

This spurious statistical comparison device has been widely and indiscriminately used by Massachusetts Bonding & Insurance Co. in its wholesale distribution of antimutual propaganda. While criticizing the mutual tax status, this particular stock company overlooked the weakness of its own tax record as shown by Best's Insurance Guide (1951 ed.) This stock company, for the years 1946–50 had a premium volume aggregating nearly $133 million, and distributed more than $3½ million in dividends to stockholders; but it incurred no Federal income taxes whatever for the entire 5-year period as a whole. In fact this stock company actually ended the period with a tax credit carry-over of more than $200,000.

Great differences in tax payments frequently develop between stock insurance companies of the same type, which approximately the same business volume, even though they are subject to the same identical tax law.

For example, during the 5-year period (1944–48), inclusive, Firemen's Insurance Co. of New Jersey, a stock fire company, with a premium volume of approximately $124,000,000 paid Federal income taxes aggregating $303,000. For the same period National Fire Insurance Co. of Connecticut, another stock fire company, with a volume of more than $125,000,000, paid Federal income taxes aggregating a little more than $8,000. Even Professor Saxon in his testimony before this committee on July 19, deplored what he calls the intellectual dishonesty of "statistical manipulation by both capital stock and mutual analysts." In the next breath, however, Professor Saxon proceeds to adopt the unfair and misleading NTEA statistics as the basis of a performance in statistical manipulation, thus providing a classic example of the practice he professed to deplore.

As pointed out in the attached reprint of editorials from the Richmond, Va., News Leader, the facts are that, for any given period of time, some mutual companies will pay relatively higher Federal income taxes than some stock companies; and some stock companies will pay relatively higher taxes than some mutuals. This is entirely natural, entirely proper, and no indication whatsoever of any "tax inequality."

MUTUAL TAXES ARE VERY SUBSTANTIAL AND CANNOT REASONABLY BE CALLED TOKEN TAXES

A typical antimutual misrepresentation is that the mutuals pay only token taxes. Considering the nonprofit character and ownership of these mutuals, Federal income taxes incurred aggregating more than $80,000,000 (1942-50), including taxes of more than $18,000,000 in 1 year, cannot fairly or reasonably be considered as merely token taxes.

MUTUALS ENJOY NO TAX ADVANTAGE BY DEDUCTION OF POLICYHOLDER DIVIDENDS BECAUSE INCOME-TAX LAW GIVES STOCK COMPANIES IDENTICALLY SAME RIGHT OF DEDUCTION

The NTEA argument that these mutuals enjoy a tax advantage over their stock-company competitors because the mutuals are permitted to deduct all dividend refunds to policyholders before computing Federal income taxes has been demonstrated to be utterly ridiculous. The Federal tax laws allow to both stock companies and mutual companies identically the same full deductions for dividend refunds to policyholders. Consequently, whatever has been said or written alleging tax discrimination, tax preference, or tax inequality, because of the dividend distribution of savings to mutual members, has no application whatsoever to mutual fire and casualty insurance companies' distribution of dividend refunds to their policyholders.

Last February Professor Saxon, speaking on behalf of the NTEA before the Committee on Ways and Means asserted that "the mutuals, because of tax inequality, can charge much lower rates by giving larger dividends." Apparently, the professor was then ignorant of the fact that stock companies have the same right as the mutuals to make policyholder refunds before computing Federal income taxes. The NTEA statistics, which the professor adopted, show in themselves that the alleged tax differential averages only a little more than $1 per $100 of premium volume. Clearly, this could not account for policyholder dividend refunds averaging $12 to $20 per $100 of premium.

In the interim Professor Saxon seems to have discovered this fact, for in his July 10 testimony before your committee, he proposed that the credit for policyholders' dividends be removed completely for both stock and mutual companies.

This shift in position by the NTEA, and its witness, reveals clearly that its program is not really "tax equality" but rather that it seeks the complete destruction of a method by which mutual, and certain stock insurance companies, have furnished insurance to the public at lower costs.

The real objective of the NTEA in its insurance activities is to prevent the continuance of this method of doing business.

The lower cost of mutual insurance is based on a combination of lower loss costs and lower expenses resulting from superior safety engineering and more efficient operation.

SLOWER GROWTH OF STOCK COMPANY ASSETS HAS BEEN CAUSED BY STOCK COMPANY DISTRIBUTION OF PROFITS TO THIRD-PARTY STOCKHOLDERS

It also has been charged that, in recent years, the growth of the assets of the mutual fire and casualty companies has been disproportionately greater than that of the stock companies. Even so, no one questions the sufficiency of the stock companies' assets. A little analysis shows the reason why the rate of growth of mutual assets has been somewhat greater. During the period 1948-49, the stock insurance companies paid cash dividends totaling $674,064,348 to their third-party stockholders. Had only a portion of these dividends been retained in the stock companies for the protection of their policyholders the gap would have been narrowed appreciably.

DIFFERENT TAX PLANS FOR STOCKS AND MUTUALS HAVE HAD NO APPRECIABLE EFFECT ON THEIR RELATIVE COMPETITIVE POSITIONS

Some antimutual critics have bitterly complained that the Federal tax status of the mutuals has had a crippling competitive effect upon their stock insurance competitors. In fact these critics have gone so far as to predict that a continuation of the two separate tax plans would inevitably result in serious progressive losses of business by the stock companies to the mutuals until the latter would completely dominate the field. Reference to the authentic records exposed the utter lack of foundation for these complaints.

In 1942 the combined stock fire and casualty volume of net premiums amounted to $1,778,920,000; while the combined mutual fire casualty volume of net premiums written amounted to $491,700,000. Thus, in 1942 the stock companies enjoyed 78.3 percent of the business.

In 1950 the combined stock fire and casualty volume of net premiums written amounted to $4,616,188,000; while the combined mutual fire and casualty volume of net premiums written amounted to $1,251,707,000. Thus, in 1950 the stock insurance companies enjoyed 78.6 percent of the combined volume.

This demonstrates that the alleged differences in the tax plans of the stocks and the mutuals have had no appreciable influence or effect upon their relative competitive situation. In view of the maintenance of stock company domination in the volume of fire and casualty insurance, what can be the real purpose of the antimutual critics of the present tax formula—the destruction of mutual fire and casualty insurance, and monopoly for stock companies?

EXISTING TAX LAWS HAVE NOT ENABLED MUTUALS TO RETAIN UNREASONABLE RESERVES

It is, of course, well recognized that all insurance companies must have, and must retain, reasonable reserves for the protection of the policyholders and the public to meet the uncertainties and contingencies of the future. Some antimutual propagandists have stated that the present tax laws have enabled these mutuals to retain larger reserves proportionately than those retained by the stock companies. Complete refutation of this charge is apparent from Best's Insurance Reports and even from the NTEA statistics. According to these NTEA statistics for the period 1913 to 1949, inclusive, the stock fire and casualty insurance companies' total premium income amounted to $20,886,290,000. During this period their surplus reserves increased $1,485,556,000. This increase amounted to 7.11 percent of premium volume. During the same period—and using the same statistics—the mutual fire and casualty insurance companies had a total premium volume of $5,810,398,000 and their surplus reserves during that period increased $363,745,000. This mutual increase is only 6.25 percent of premium volume.

"MUTUAL" HAS PRECISE MEANING IN INSURANCE

Antimutual propagandists contend that the word "mutual" has no significance in connection with a large fire or casualty insurance company, and that it is "only incidental" that the "capital" of a mutual insurance company comes from its policyholder-members, while that of a stock insurance company is subscribed by its stockholders. The answer is, the fact that a stock insurance company belongs to its third-party stockholders, while a mutual insurance company belongs solely to its policyholder-members, is a fundamental difference between the two types of insurance organizations; it has far-reaching legal and economic consequences and it is not "merely incidental."

It has been charged that there is no "mutuality of interest between the mutual policyholders because they vary greatly in their locations, business and property." The answer is, there is a definite mutuality of interest among all of the policyholders in a mutual insurance company, regardless of the variety of their property, their individual locations or their vocations. They have the common interest of protecting themselves effectively from economic loss at the lowest cost compatible with sound protection, and an interest in being willing to exercise the degree of care and personal responsibility which mutual insurance companies require of their members.

Members of fraternal, religious, political, or labor organizations, for example, also may be widely separated geographically, and may vary widely in other respects; and yet no one could reasonably argue that they do not have mutuality of interest as to their basic objective.

Some critics characterize the nonprofit nature of mutual insurance as the "nonprofit myth", but they have never been able to demonstrate that any "profits" are derived from the insurance operations of a mutual insurance company. These critics quarrel also with the fact that the very nature of insurance prohibits the precise determination of the actual cost to any insurance company of carrying any individual risk; but these critics ignore the well-known fact that insurance—whether stock or mutual or otherwise—cannot operate other than through the averaging process.

TAXATION OF INSURANCE SURPLUS IS NOT IN THE INTEREST OF THE PUBLIC

Some questions have been raised about the possible taxation of additions to policyholders' surplus. Mutual insurance companies and their policyholders believe that taxation of funds accumulated for the sole purpose of providing against present losses and for future protection is basically unsound. Such taxation would be most undesirable from the standpoint of the insuring public.

Additions to policyholder surplus are made for the purpose of providing the necessary protective reserves—which are required either by law or by sound business judgment, or both—for the protection of the policyholders who have paid in their premiums. Unquestionably, it is to the best interest of the general public that insurance companies of all types should acquire and maintain adequate reserves to guard against the losses for which the insurance is provided. While the policyholders' surplus of these mutuals has steadily increased through the years, this increase has only been in keeping with the increase in the total amount of risk assumed by mutual insurance companies. Any independent examination of the policyholders' surplus of the mutuals makes it obvious that, while this surplus is reasonable, it is in no degree excessive in relation to potential insurance liability at risk. Apart from all of the listed considerations, the policyholders' surplus of the mutuals remains the property of the policyholders.

TAXING MUTUALS AND STOCKS ON SAME PLAN WOULD NOT END THE CONTROVERSY

Some ask: "Why not tax both mutual and stock fire and casualty insurance companies on the same plan, and end all this controversy?"

The simple fact is that both mutual and stock fire and casualty insurance companies pay substantial Federal income taxes—they each pay taxes upon that portion of their net margins which the law considers to be "profits." In the mutual company this is "net income from investments;" in a stock company this is the combination of "net income from underwriting and investments." In addition, a mutual company is subject to "tax floor" of 1 percent of its gross income, even if this must be paid out of funds that are not properly considered "profits."

As heretofore pointed out, fundamental differences in structure, ownership, purpose, and operational methods not only justify but actually require different tax plans between these mutuals and the stock companies so as to avoid injustice to one group or the other.

We do not believe that the Congress will make revolutionary changes in the tax structure of these mutuals merely to appease the propaganda-inspired complaints of critical competitors.

The differences between mutual and stock insurance are so clear-cut as to be obvious, and they have been reviewed in this statement. Such differences as exist in the amounts of "profits" subject to Federal income tax are differences which develop with inescapable logic out of a simple fact: The margin between the amount collected from policyholders and the amount required to furnish them with insurance protection is a fund which belongs to the policyholders in a mutual company, but it is a fund which belongs to the stockholders in a stock insurance company.

CONCLUSION

We are not here criticizing the tax status of the stock companies, nor do we suggest any change therein. We have referred to the stock companies only because it has been necessary to do so to accomplish the sole purpose of this statement—namely, to answer and refute the unfair and misleading attacks which have been made on the tax status of the mutual fire and casualty insurance companies.

It is true that mutual fire and casualty insurance companies are taxed on a basis different from stock insurance companies, but that fact does not prove that the different methods of taxing these different types of insurance companies result in tax inequality, tax discrimination, or any "loop-hole" in the Federal income-tax laws. On the contrary, the different bases of taxation exist because of the very real and fundamental differences between stock insurance companies on the one hand and mutual insurance companies on the other hand.

The fact that both types of companies pursue many similar business practices in the course of their operations in no way destroys or modifies their basic differences in character and purpose. For many years, mutual fire and casualty insurance companies have been paying substantial Federal income taxes year in and year out, regardless of whether the operating experience of these companies is favorable or unfavorable. The income taxes paid by these mutuals constitute a steady and substantial and constantly increasing source of Federal Government revenue.

The Congress is being subjected to an increasing flood of communications, inspired by the deliberate distortions and malicious misrepresentations of NTEA and other antimutual groups.

However, if the views of the more than 20,000,000 mutual policyholders were to be communicated to the Congress, they would be based upon truth and logic. Furthermore, they would far outnumber and outweigh all the antimutual communications from every source.

Important tax changes, affecting a vital Nation-wide industry such as mutual insurance, should never be influenced by partisan propaganda. Consideration of any such changes should come only after careful, impartial and objective study of the important subject of taxation of mutual insurance.

SUMMARY OF CROSS EXAMINATION OF JOHN J. WICKER, JR., BY HOUSE COMMITTEE ON WAYS AND MEANS, MARCH 15, 1951

Upon conclusion of presentation of Mr. Wicker's statement, committee chairman R. L. Doughton inquired why—if mutual insurance companies have no tax advantage over stock insurance companies under present law—both should not be placed in exactly the same category in order to stop arguments. Wicker pointed out that the two types of companies are entirely different in corporate structure, purpose, and organization, and that simply because they are competing with each other is no reason for their being placed in the same tax basket. He pointed out that all of the funds which come in to a mutual insurance company come from the policyholders, and that even in a stock company the funds which the stockholders have contributed in order to get the business started are only a drop in the bucket as compared with the funds which policyholders contribute to these stock insurance companies.

Chairman Doughton inquired whether the statement that the management of a mutual insurance company is in the hands of the policyholders is true in reality or just in theory. Wicker pointed out that perhaps a parallel situation exists in the degree of management exercised by the stockholders of a stock corporation, who also have the right to control the business. He gave it as his opinion that the degree of participation by policyholders in the mutual insurance company is larger than the degree of participation by stockholders in the average stock insurance company.

Chairman Doughton inquired whether management of mutual insurance companies receive large salaries. Wicker disclaimed knowledge of the subject, but suggested that if the committee wished to write the five largest mutual and the five largest stock fire and casualty insurance companies as to the salaries paid their presidents, he would pledge that the mutual officials would reply.

Chairman Doughton inquired whether the savings returned to policyholders constitute profits; Wicker stated that the amounts turned back to policyholders are in the nature of an overpayment by the policyholder when he pays his original premium, and that there is no profit to the policyholder.

Representative D. A. Reed, member of the committee, inquired as to how voting rights are determined in a mutual insurance company, and how the amount of premiums to be collected is determined. He summarized his understanding of the situation by stating that good management requires that mutual insurance companies make their estimates of premiums required large enough to cover their probable losses so that it will not be necessary to come back to the policyholders for additional payments, that people wish to protect themselves by paying a large enough premium so the company will be sound, and that they know they will have returned to them what is not required by the company. He asserted that he could see no profit in such a situation.

Representative Reed also took occasion to criticize sharply the National Tax Equality Association, characterizing it as "one of the worst racketeering organizations that was ever permitted to exist in this country."

Wicker pointed out that some of the misstatements which have been circulated around the country have tried to make a left-handed attempt to connect mutual insurance with communism, despite the fact that mutual insurance is conducted today on identically the same principles as it was founded upon by men such as George Washington, Benjamin Franklin, and Thomas Jefferson.

Representative H. P. Eberharter, member of the committee, inquired about the claim that had been made by previous witnesses that if mutual fire and casualty insurance companies were taxed upon the same basis as stock fire and casualty insurance companies it would mean additional Federal revenue of $60,000,000. Wicker explained that this statement was based upon distortion of statistics that ignored return of $842,422,052 in savings or dividends to policyholders. He stressed the fact that mutual policyholders who are engaged in business pay Federal income taxes upon dividends returned to them by their mutual insurance companies, in the sense that these are offset against deductions taken as business expense for insurance premiums paid, and that in 1949 Federal income-tax revenue on this account actually exceeded $40,000,000. He said it was estimated that 80 percent of the savings refunded by mutual fire and casualty insurance companies are to commercial policyholders, that Federal income taxes are paid on this money, and that a 30-percent tax rate would be about the average in recent years.

Representative R. W. Kean, member of the committee, inquired whether money paid in by policyholders is so used as to result in earnings for the mutual insurance company. Wicker explained that money received from policyholders indeed is invested by a mutual company, but in response to a further question by Representative Kean said that such earnings have been taxed to mutual fire and casualty insurance companies at the regular corporation rates since 1942.

Representative N. M. Mason, member of the committee, said: "If there is any one member of this committee interested in tax equality I think I am he. I am interested in tax equality on these mutual fire insurance and mutual casualty insurance companies. I have gone into this matter with our staff and with Mr. Stam. I have been assured by our staff that since 1942 when the Congress by law placed a tax upon the mutual insurance companies, either the corporate tax upon the net income of your companies, or 1 percent of the gross income of your companies, whichever is the larger. Since that time the payment from the mutual insurance companies has fluctuated with that of the stock companies, but as a whole they have at least equaled what the stock companies have had to pay because even when you could not show any net profits or net income, you had to pay 1 percent on your gross income, which the stock companies do not have to pay. So from what our staff has told me and from the tax basis upon which you are now being taxed since 1942, I feel that your mutual insurance companies, both fire and casualty, have been paying their proportionate share of taxes as well as the stock insurance companies. I am honest enough to assert that here in public. I think you are in a different class entirely from mutual savings banks and the building and loan associations because of this tax which was placed upon you in 1942. I think up until that time there was a little reason for some questioning."

Representative B. P. Harrison, member of the committee, inquired whether the fact that mutual companies charge policyholders considerably less than stock companies do for insurance is due to a tax differential, or what does account for the ability of mutual companies to return dividends. Wicker said that the tax differential's effect is negligible, but that savings could be returned because of the mutuals' lower selling cost, their lower losses due to fire prevention and safety engineering activity, and the fact that there were no third-party stockholders to whom dividends have to be paid.

Representative T. E. Martin, member of the committee, asked for further information upon the previous Wicker testimony that the mutual insurance premium dollar already produces more Federal income-tax revenue than the stock insurance premium dollar.

Wicker explained that from 1943 through 1949 Federal income taxes paid by mutual fire and casualty insurance companies were $62,207,000. Assuming that 80 percent of mutual policyholders to whom savings are returned are commercial policyholders, and that their Federal income tax rate averages about 30 percent, the income tax liability of mutual commercial policyholders on dividends returned during the 1943–49 period was about $202,000,000. Added to the Federal income taxes paid by the mutual fire and casualty insurance companies themselves that gives a total of $264,478,000, or 4.54 percent of the gross total mutual premium volume for the period.

During the same period the stock fire and casualty insurance companies paid $494,195,000 in Federal income taxes, and returned as savings to their policyholders $136,941,000. Applying the same 30 percent average Federal income tax rate, and assuming that 80 percent of the stock insurance policyholders are commercial policyholders, these policyholders had tax liability of $32,085,840. Stock companies also paid during that period $674,054,000 to their stockholders. Assuming again an average tax rate of 30 percent, these stockholders incurred tax liability of $192,210,000. So the total of Federal income tax liability of stock fire and casualty insurance companies, their policyholders on account of returned savings, and their stockholders on account of stockholder dividends was $729,277,000 for the 1948–49 period. This is only 3.5 percent of the gross total stock premium for that period.

Chairman Doughton asked what becomes of savings returned to policyholders as far as taxation is concerned, either as to stock or mutual policyholders, if the policyholders do not pay taxes on these refunds. Wicker said that the commercial policyholder incurs Federal income tax liability on these refunds, assuming that he has deducted the original cost of his insurance as a business expense. The insurance company—stock or mutual—does not pay Federal income tax on these savings returned to policyholders, any more than another type of businessman would pay Federal income tax on discounts he allows his customers.

Chairman Doughton inquired as to the difference, as far as taxation is concerned, between the dividends paid to a stockholder in an insurance company, and the savings or dividends returned to a policyholder as a refund of the unused portion of his insurance premium. Wicker indicated that a dividend paid to a stockholder of an insurance company who had invested his money in the organization in the hope of earning a profit would be taxable like any other income the stockholder receives. The savings or dividend refunded to a policyholder likewise would be taxable to a commercial policyholder like any other income, in the sense that it offsets the deduction of the cost of his insurance which the commercial policyholder previously has made as a business expense.

Federal Government actually derives more tax revenue proportionately from mutual fire and casualty insurance than from stock insurance

[As shown by following comparison for the entire period (1942–50 inclusive) that present tax laws (sec. 204 for stock insurance; sec. 207 for mutual insurance) have been in effect]

	Stock companies	Mutual companies
Gross premium volume	$34,825,000,000	$7,490,000,000
Less dividend refunds to policyholders	179,458,000	1,144,407,000
Net total premium volume	34,645,542,000	6,345,593,000
Net underwriting income[1]	642,040,000	228,978,000
Net investment income	2,374,900,000	303,171,000
Total profits (net underwriting and investment income)	3,016,940,000	532,149,000
Income tax incurred:		
By companies	634,272,000	80,803,000
By commercial policyholders on dividend refunds	43,069,920	346,657,680
By stockholders	296,510,676	....
Total income tax incurred	973,852,596	427,460,680
Ratio of total tax:		
To net total premium volume ... percent	2.81	6.67
To total profits (net underwriting and investment income) ... percent	32.27	80.32

[1] After deduction of dividend refunds to policyholders.

Source: For 1942, Best's Insurance Reports and Best's Aggregates and Averages; for 1943–49 inclusive, Best's Aggregates and Averages; for 1950, Best's Insurance Guide (1951 edition).
Exhibit: American Mutual Alliance statement filed with Senate Finance Committee, August 1951.

Federal Government actually derives more tax revenue proportionately from mutual fire and casualty insurance than from stock insurance

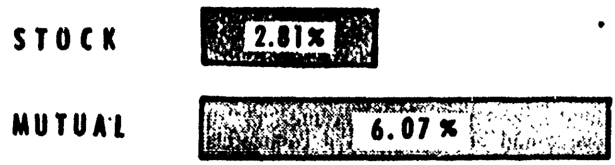
[As shown by following comparison for the entire period (1942-50 inclusive) that present tax laws (sec. 204 for stock insurance; sec. 207 for mutual insurance) have been in effect]

	Stock companies	Mutual companies
Net total premium volume	$34,645,542,000	$6,346,593,000
Total profits (net underwriting and investment income)	3,016,940,000	532,149,000
Total income tax incurred [1]	973,852,596	427,460,680

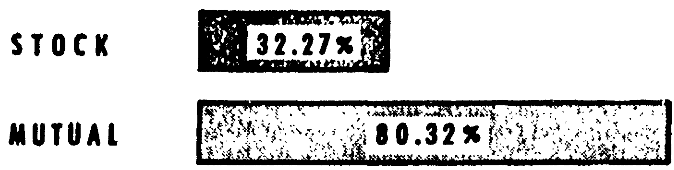
[1] By companies, by commercial policyholders on dividend refunds, and by stockholders.

Source: For 1942, Best's Insurance Reports and Best's Aggregates and Averages; for 1943-49 inclusive, Best's Aggregates and Averages; for 1950, Best's Insurance Guide (1951 edition).

COMPARISON OF TAXES AS PERCENTAGE OF PREMIUM VOLUME:



COMPARISON OF TAXES AS PERCENTAGE OF TOTAL "PROFITS":



[From the Richmond News-Leader, March 19, 1951]

WHOSE STATISTICS?

One of the arguments raised in the House of Representatives by supporters of the Reconstruction Finance Corporation dealt with the RFC's benefit to small business. It was submitted, for example, that in the last 6 months of 1950, some 89.55 percent of the RFC's loans were small-business loans in amounts of less than $100,000. There's another way of looking at it. When one considers the abuse of discretion in the handling of large sums of the taxpayers' money—which was the principal point at issue—it is of passing interest to note that dollarwise, only 28.37 percent of the RFC's loans were in this small-business classification. More than two-thirds of the RFC's loan volume in this period went to business that was pretty big, indeed.

We are reminded in this connection of the phony assault made recently on the mutual insurance companies. Some of the stock company spokesmen hollered that approximately 80 percent of the mutuals are tax exempt. But what they failed to disclose was that mutuals with 97 percent of the premium volume are not tax exempt at all.

In these days, when figures are flying every which way, it is a good idea to look all gift statistics in the mouth. A lot of them are like Senator McCarthy's charges—sound and fury, signifying nothing.

[From the Richmond News-Leader, March 28, 1951]

MISLEADING, HE SAYS OF INSURANCE STATISTICS

EDITOR THE NEWS-LEADER:

Speaking of "Whose Statistics?" [March 10], the least I would think one could say is that yours are certainly misleading.

HARRY F. THOMPSON,
Manager, Virginia-Carolina Department,
Boston Insurance Co., Old Colony Insurance Co.

Reader Thompson refers to our criticism of tactics used by stock insurance companies in warring upon the mutuals. Among the statistics put out by the stock companies was a statement that 80 percent of the mutual fire and casualty companies are tax exempt. The figure was the truth but not all the truth. The truth is that the small companies making up this 80 percent account for less than 3 percent of the total volume of mutual premiums; the companies with 97 percent of the premium volume are not tax exempt. Mr. Thompson's further ammunition is commented upon editorially today.—EDITOR.

[From the Richmond News Leader, March 23, 1951]

FIGHTING THINGS OUT WITH STATISTICS

A Richmond insurance man, writing in today's Forum, charges that certain figures we presented editorially on March 10 were certainly misleading. Our correspondent is a partisan for the stock insurance companies, who now are engaged in a knock-down-and-drag-out battle with the mutual-insurance companies. These combatants, represented on both sides by well-heeled lobbies, are pounding at each other before the House Ways and Means Committee. It is a whale of a fight, and important to every person who carries fire insurance on his home or liability insurance on his automobile, but our observations today are concerned not with the outcome, but with the weapons. This donnybrook is being fought with statistics, as so many Washington rhubarbs are fought these days, and the struggle emphasizes all over again the advisability of teaching some statistical analysis in the public schools. It has been said that statistics, like quotations from Jefferson, can be used to prove anything; the stock insurance companies are giving this maxim a wonderful time.

Our correspondent, for example, in an earnest effort to set us aright on the question at issue, sends along a hand-out from the W. J. Perry insurance office in Staunton. These widely publicized statistics, which appear in table I, are for the year 1949 alone; they are supposed to show how lightly the mutuals are taxed and how heavily the stocks are burdened. At first glance, the figures look powerfully impressive. But look at table II. It sums up premium and tax figures for the identical companies in 1946. From these statistics, it seems apparent that the stock companies had a free ride while the mutuals were paying heavily.

The facts are, of course, that mutuals and stocks are fundamentally different in their structure and operations, and they wisely are taxed on a different basis. In a lean year, the mutuals pay relatively high taxes, while the stocks pay low ones; in fat years, the picture is reversed. The mutuals are not getting any free ride; the stocks apparently are putting up a fair share of the tax burden. There's merit on both sides, but to read their statistics—and especially the stock companies' statistics—you'd never on earth believe it.

TABLE I

Company	1949 net premiums	1949 Federal income tax
Maryland Casualty	$60,012,000	$1,553,830
American Mutual	62,227,000	533,610
Travelers Indemnity	73,550,000	3,546,605
Lumbermen's Mutual	83,526,000	777,988
U. S. F. & G	100,071,000	2,732,250
State Farm Mutual	82,448,000	874,917
Indemnity of N. A	44,301,000	1,569,140
Hardware Mutual	32,788,000	279,802
Hartford Accident & Indemnity	115,019,000	3,562,455
Liberty Mutual	131,411,000	1,497,959

TABLE II

Company	1946 net premiums	1946 Federal income tax
Maryland Casualty	$38,083,000	None
American Mutual	36,756,000	$525,000
Travelers Indemnity	40,421,000	None
Lumbermen's Mutual	44,218,000	398,000
U. S. F. & G	56,026,000	None
State Farm Mutual	61,121,000	697,000
Indemnity of N. A	27,647,000	121,000
Hardware Mutual	21,473,000	182,000
Hartford Accident & Indemnity	66,892,000	None
Liberty Mutual	74,527,000	1,144,000

Senator BYRD. Following Mr. Wicker's testimony, I have a statement from the opposing side, which I will insert.

(The statement referred to by the National Association of Insurance Agents follows:)

STATEMENT OF THE NATIONAL ASSOCIATION OF INSURANCE AGENTS

There is a distinct inequality in the method of taxing mutual and stock fire and casualty insurance companies.

The facts are:

1. Stock fire and casualty insurance companies are taxed at regular corporate and capital gain rates under section 204 of the Internal Revenue Code.

2. Mutual fire and casualty companies are taxed under section 207 of the Internal Revenue Code, which provides a tax of 1 percent of their premiums or corporate rates on their investment income whichever is the larger.

Both sections 204 (*c*) (11) and 207 provide for deductions on otherwise taxable income, in the form of "dividends or similar distributions paid or declared to policyholders in their capacity as such * * *. The term 'paid or declared' shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company."

Thereby there was conferred upon mutual companies a tax privilege which has raised the issue of inequality in taxing insurance companies. The simple question here involved is as to whether all insurance companies, both stock and mutual, should be taxed on a corporate basis on the net income, as ordinarily understood in the insurance business, or whether a Federal preference shall be provided for mutual companies.

We believe that any tax structure created by the Congress on corporations should have as its definite intention, the levying of a tax on the net income of a corporation before dividends are distributed. It would therefore appear that the exemption provided in section 204 (*c*) (11) and section 207 of the Internal Revenue Code should be eliminated or other provision made for equality of taxation as applied to all insurance corporations.

Senator MILLIKIN. Mr. Chairman, I would like to request that this advertisement and letter of transmittal mentioned by Mr. Wicker be incorporated at the end of his remarks.

Senator BYRD. It will be done.

(The advertisement referred to follows:)

NATIONAL TAX EQUALITY ASSOCIATION,
Chicago 4, Ill., July 20, 1951.

DEAR MEMBER AND FRIEND: The Senate Finance Committee is now rewriting the 1951 tax bill. Chairman George, of Georgia, and other members of this tax-writing committee have repeatedly stated they intend to include provisions that will tax the profits of co-ops, mutuals and other tax-exempt commercial businesses.

They should have as much public support as possible. One sure way to develop this backing in your own community is through the use of newspaper advertising. We are enclosing proofs of four new newspapers advertisements, which we would like to see published in your community. We suggest that you get in touch with your local newspaper man and two or three of your business friends. Together, you can quickly make the necessary financial arrangements to underwrite the small cost of publishing these ads in your home city newspaper.

We will supply mats, free and postpaid, upon receipt of the enclosed order blank from you or your newspaper. The ads can be started at once, running one ad per week for 4 weeks.

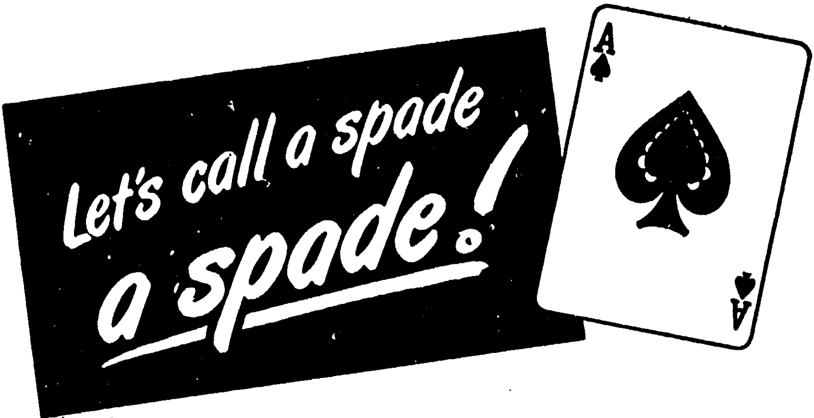
The name of this association may be used at the bottom as the sponsor, or the ads may be signed by your local State tax equality organization, or "Local Independent Taxpaying Businessmen"[1] if you have no local or State group. Just send the order blank and we will take over from there and communicate direct with the newspaper you designate thereon.

These ads should appear in every American city to arouse taxpayers to the necessity of demanding that tax-exempt businesses—now escaping a billion dollars in income tax every year—be fully taxed before your or anyone else's taxes are again increased. Please call your newspaper and a number of your business associates now and enlist them in seeing that these ads are underwritten for publication in your city.

Tax equality can be achieved in this 1951 tax bill if we act now.

Very truly yours,

GARNER M. LESTER, *President.*



Congress is playing politics with YOUR INCOME!

CONGRESS is about to boost *YOUR* income tax again. At the same time, purely for ulterior political reasons, still permits income tax exemption to more than 35,000 profit-making business corporations. Congress allows *ONE OUT OF TEN* corporations to pay little or no Federal income tax on their business profits. Congress lets them escape taxes of more than *ONE BILLION DOLLARS A YEAR*...while taxing *YOU* more!

Congress adds that billion dollars onto the tax bill of *you* and every other income taxpayer. Their political chicanery is costing you money ...will soon cost *you* more unless *you demand an end to this tax discrimination.*

These profit-making businesses coddled by Congress...in return for political favors from their leaders and promoters ...are COOPERATIVES, SAVINGS AND LOAN ASSOCIATIONS, MUTUAL SAVINGS BANKS, CREDIT UNIONS, and other cooperative banks and corporations of this kind. Even some MUTUAL FIRE AND CASUALTY INSURANCE COMPANIES are given favored tax treatment that adds to *YOUR* tax bill.

It is time *you* protested against Congress making a political football out of your pay check, your pocketbook, or your business income. Write your Congressman and your two United States Senators *immediately*.

The House of Representatives has *ALREADY PASSED* the new 1951 tax bill raising your individual and business income taxes by billions, but doing absolutely nothing to tax the billions in profits of these tax-exempt corporations. This legislation is *NOW* before the Senate.

Make your resentment of this *tax discrimination* against *you* heard in the halls of Congress. Write your Congressman and Senators today. Demand that they tax the untaxed *first*, before increasing your or anyone else's Income Tax again.

* * *

Write your Congressmen—c/o House Office Bldg.

Write your Senators—c/o Senate Office Bldg.

WASHINGTON, D. C.

(IMPRINT)

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[1] Suggested fictitious name.

Senator BYRD. Mr. Theodore K. Warner, Jr.

STATEMENT OF THEODORE K. WARNER, JR., CHAIRMAN, FEDERAL TAXATION COMMITTEE, PENNSYLVANIA STATE CHAMBER OF COMMERCE

Mr. WARNER. Mr. Chairman and gentlemen of the committee, my name is Theodore K. Warner, Jr.

I am an attorney in Philadelphia, and chairman of the Federal taxation committee of the Pennsylvania State Chamber of Commerce.

It is my privilege today to present the views of that business organization.

In view of the time limitation, I shall ask leave to submit our statement, and I shall summarize certain portions of it.

We can appreciate some of the difficulties encountered by your committee in formulating tax legislation in this trying period. No one wants to pay higher taxes, but unless the $68 billion in expenditures forecast by Secretary Snyder for 1952 can be cut substantially—and we think they should be—there will apparently be a sizable deficit if taxes are not decreased.

I understand that much higher Federal spending is being forecast for 1953. State and local government budgets are approximately $20 billion. To balance our rising governmental budgets—they should be balanced in this inflationary period, if at all possible—will require taxes which are equivalent to one-third or more of our National income.

Our organization commends the constructive work of the members of this committee who are advocating the elimination of waste in both military and nonmilitary spending.

We are also convinced that the first approach to the perplexing tax problem should be the removal of wasteful and inflationary spending by the Federal, State, and local governments.

If taxes must be increased to balance the 1952 budget, we believe the new taxes should be directed toward a major source of inflation, consumer spending. The present stem of excises is no longer adequate to provide the revenues required from consumer taxes. Of total consumer spending of $179 billion in 1949, according to Secretary Snyder, only $4.6 billion, or 22.7 percent, were subject to Federal taxation. A huge area of consumer spending, in spite of its inflationary pressure, is not being taxed.

The present excises are also discriminatory in their effects. Some lines of consumption, without any clear reason, are singled out for especially heavy taxation. Some competing lines are not taxed at all. Some industries must struggle along under a heavy tax load which they endeavor to shift to consumers while other industries are free from this handicap.

Our selective excises have had a long historical development and will doubtlessly need to be retained in some form, preferably along more rational lines. Canada, Britain, and other leading national governments have eventually found it necessary to supplement their traditional sources of revenue with a broad consumer tax. We believe that the time has come in this country, when personal and corporate income taxes have already been pushed to staggering heights, that any new revenues required should be sought in the consumer area in order to prevent the overburdening of investment and production and to discourage inflationary consumer spending.

Two general types of consumer taxation are available, the one to be imposed at the manufacturing level and the other at the retail level. Either would be preferable to increases in the individual and corporate income taxes. Along with the majority of the State chambers of commerce affiliated with the Council of State Chambers of Commerce, we in Pennsylvania believe a consumer purchase tax, collected through retailers, would be superior to a tax collected through manufacturers.

We fear that hidden taxes would invite governmental extravagance, ever-increasing budgets, and still higher taxes. A tax on retail purchases would bring home to the citizens the gravity of our financial situation and enable them to contribute fairly to the cost of national defense.

A tax at the retail level, charged separately to purchasers, would disturb price ceilings less than a tax on manufacturing or wholesaling. It would enter into business costs to a much lesser extent and would not pyramid from producer to producer and dealer to dealer. Because the tax would have a broader base, it could raise an equivalent amount of revenue at a lower rate.

A tax on retail purchases could be excluded from cost-of-living wage contracts, unlike a tax on manufacturing, which would commonly be concealed in retail prices. This would be an important factor in the fight against inflation. Unless selective and general excise and income taxes, imposed to finance defense expenditures, are excluded from escalator clauses in wage contracts to the extent their burdens on individuals are known, those receiving higher wages under such contracts will escape their fair share of national defense costs. Similarly, a tax on retail purchases could be eliminated from parity prices for farm products much more readily than a tax on manufacturing.

From an administrative standpoint, a tax on retail purchases could be administered within the existing framework of the Bureau of Internal Revenue organization. Ample precedent for filing returns and paying the tax exists in the present regulations relating to the selective retailer's excises, to which many retailers are already subject, and the social-security tax, which affects almost all retailers. In many cases, the total taxable sales for the year would be the same amount as the total sales shown on the retailer's income-tax return. It is believed that a Federal tax on retail purchases could be collected without undue inconvenience to the retailer or the Government.

To minimize the taxation of the lower incomes, purchases of foods in the retail markets to be consumed off the premises should be exempt. It is assumed that rentals for living quarters and payments for the purchase of homes would not be taxed. A large part of the typical family budget would thus be exempt from taxation.

The type of tax on purchases at retail which we propose should yield an annual revenue of approximately $1 billion at 1 percent and proportionately more revenue at a higher rate.

These are the several reasons why the Pennsylvania State Chamber of Commerce would prefer a general consumption tax at the retail level. Other witnesses appearing before you have emphasized the advantages of a tax at the level of final manufacture.

We noted that businessmen, in general, are in agreement of the desirability of some type of broad base consumer tax. Our group favors it at the retail level.

Heavier consumer taxation is one of the harsh requirements in this critical period, if we are to go ahead and fight inflation as well as the Communists.

But the inflation which inevitably would be engendered by deficit spending would be far more destructive of living standards and American institutions than higher taxes.

There are no exemptions from inflation. It hits the poorest along with the richest.

If additional revenues must be raised, after consumer taxation has been increased to its rational limits, we would favor a higher tax on personal incomes. But the tax increase in the House bill seems to us to be harsh and inequitable. We would prefer a flat increase of not over 8 percentage points on each bracket of surtax net income. More desirable, since the higher brackets already pay very steep taxes, would be to add any additional tax imposed as a flat rate increase upon the income remaining after exemptions, deductions, and present income taxes.

We oppose the increased taxation of capital gains and the lengthening of the holding period for capital assets as measures which would discourage risk taking and productive investment. As a general principle, we believe that capital losses should be recognized to the extent that capital gains are taxed.

After thoughtful consideration, we wish to register our opposition to the introduction of the proposed withholding taxes on dividends, interest, and royalties at this time. The enumeration of the dividends and interest received by the taxpayer on his return and the complete reporting by corporations of dividends distributed should first be given a fair trial.

As an organization of businessmen, we are opposed to the proposed increase in the normal tax on corporations from 25 to 30 percent, resulting in most cases in an over-all tax rate, exclusive of excess-profits taxes, of 52 percent, retroactive to January 1, 1951. Even during World War II the maximum tax upon corporations not subject to the excess-profits tax was 40 percent. The proposed rate imposes an unconscionable burden upon productive enterprise.

We oppose the provision in the House bill reducing the excess-profits credit based on income from 85 percent of the taxpayer's base period average earnings to 75 percent of such earnings.

The effect of such a provision would be to subject 25 percent of a taxpayer's admittedly normal earnings to an excess-profits tax, with a combined rate upon a portion of the income as high as 82 percent.

We believe that such action is wholly unwarranted. In view of the continuing decline in the purchasing power of the dollar, it would be more realistic and equitable to increase the credit to 100 percent of average earnings. This would provide some measure of relief against the necessity of paying excess-profits taxes on more inflated dollar profits which do not, in fact, reflect any increased economic benefit.

The effect of these changes has been presented to you by Secretary Snyder (table 16) which indicates that a corporation, whose present income is identical with that in the base period, will be taxed 54 to 59.4 percent. This exceeds even the recommendation of a 55-percent rate proposed by the Treasury Department.

Furthermore, the maximum tax upon every dollar of corporate income would be increased from 62 to 70 percent, leaving but 30 percent for capital expenditures, debt payments, and dividends.

We are opposed to the provision in the House bill which would allow only one surtax exemption and one minimum excess-profits credit to a related group of corporations.

Many of our industries find it necessary to operate by means of two or more corporations under arrangements which were made years ago solely for business reasons and without regard to Federal income or excess-profits taxes.

In such cases, each of the corporations is a valid, subsisting corporation. The proposed provision, however, would in practical effect refuse to recognize the separate existence of these corporations and to this extent would repudiate the corporate entity theory of taxation, which has been sustained in numerous court decisions.

The allowance of a single credit to related corporations would be similar to the single credit now granted to affiliated corporations filing a consolidated return. Incongruously, however, the law exacts a penalty from those corporations which choose to file a consolidated return. If a provision of this type is necessary to prevent tax evasion, it should be aimed only at those whom it is intended to affect.

We, therefore, recommend that if such a provision is found to be necessary, it should be applicable only to those corporate divisions which occur after January 1, 1951, and which are undertaken without a legitimate corporate business purpose other than tax reduction.

Then there are technical amendments which are not appropriate to present at this time at any length. On the other hand, we never seem to have any opportunity to present these technical problems which are thorns in the flesh, so I will just enumerate them.

Under the historical method, the taxpayer must make his election with his return. Under all other provisions he has the opportunity later to take the higher credit. This way, if his guess is right, he pays a fair amount of tax. If his guess is wrong, the Government has a windfall.

The net capital addition under the historical method is not 12 percent, as it is under the others, and it should be.

Your estimated base period net income on industry classification works out inequitably and there are many publications on that issue.

Many corporations have attacked the $20,000,000 limitation on the growth formula. The inadmissible assets factor should be applied as it was in World War II, rather than the present excess-profits-tax law.

On the income tax, we notice that they have corrected one of the inequities on the sale of a residence. We hope that sometime they will get around to considering the problems of the corporations operating in foreign countries with your foreign tax credit.

Then there is the 2-percent penalty, and all the other things that you have heard comments upon at many other occasions.

Thank you very much.

(The prepared statement of Theodore K. Warner, Jr., previously referred to, follows:)

STATEMENT OF THEODORE K. WARNER, JR., ON BEHALF OF THE PENNSYLVANIA STATE CHAMBER OF COMMERCE

Mr. Chairman and gentlemen of the Senate Finance Committee, my name is Theodore K. Warner, Jr. I am an attorney in Philadelphia and chairman of the Federal taxation committee of the Pennsylvania State Chamber of Commerce. It is my privilege today to present the views of that business organization.

I can appreciate some of the difficulties encountered by your committee in formulating tax legislation in this trying period. No one wants to pay higher taxes, but unless the $68 billion in expenditures forecast by Secretary Snyder for 1952 can be cut substantially—and we think they should be—there will apparently be a sizable deficit if taxes are not increased. I understand that much higher Federal spending is being forecast for 1953. State and local government budgets are approximating $20 billion. To balance our rising governmental budgets—and they should be balanced in this inflationary period, if at all possible—will require taxes equivalent to one-third or more of our national income.

Our organization commends the constructive work of the members of this committee who are advocating the elimination of waste in both military and nonmilitary spending. We are also convinced that the first approach to the perplexing tax problem should be the removal of wasteful and inflationary spending by the Federal, State, and local governments.

If taxes must be increased to balance the 1952 budget, we believe the new taxes should be directed toward a major source of inflation, consumer spending. The present system of excises is no longer adequate to provide the revenues required from consumer taxes. Of total consumer spending of $179 billion in 1949, according to Secretary Snyder, only $40.6 billion, or 22.7 percent, were subject to Federal taxation. A huge area of consumer spending, in spite of its inflationary pressure, is not being taxed.

The present excises are also discriminatory in their effects. Some lines of consumption, without any clear reason, are singled out for especially heavy taxation. Some competing lines are not taxed at all. Some industries must struggle along under a heavy tax load which they endeavor to shift to consumers while other industries are free from this handicap.

Our selective excises have had a long historical development and will doubtlessly need to be retained in some form, preferably along more rational lines. Canada, Britain, and other leading national governments have eventually found it necessary to supplement their traditional sources of revenue with a broad consumer tax. We believe that the time has come in this country, when personal and corporate income taxes have already been pushed to staggering heights, that any new revenues required should be sought in the consumer area in order to prevent the overburdening of investment and production and to discourage inflationary consumer spending.

Two general types of consumer taxation are available, the one to be imposed at the manufacturing level and the other at the retail level. Either would be preferable to increases in the individual and corporate income taxes. Along with the majority of the State chambers of commerce affiliated with the Council of State Chambers of Commerce, we in Pennsylvania believe that a consumer purchase tax, collected through retailers, would be superior to a tax collected through manufacturers.

We fear that hidden taxes would invite governmental extravagance, ever-increasing budgets and still higher taxes. A tax on retail purchases would bring home to the citizens the gravity of our financial situation and enable them to contribute fairly to the costs of national defense.

A tax at the retail level, charged separately to purchasers, would disturb price ceilings less than a tax on manufacturing or wholesaling. It would enter into business costs to a much lesser extent and would not pyramid from producer to producer and dealer to dealer. Because the tax would have a broader base, it could raise an equivalent amount of revenue at a lower rate.

A tax on retail purchases could be excluded from cost-of-living wage contracts, unlike a tax on manufacturing, which would commonly be concealed in retail prices. This would be an important factor in the fight against inflation. Unless selective and general excise and income taxes, imposed to finance defense expenditures, are excluded from escalator clauses in wage contracts to the extent their burdens on individuals are known, those receiving higher wages under such contracts will escape their fair share of national defense costs. Similarly, a tax on retail purchases could be eliminated from parity prices for farm products much more readily than a tax on manufacturing.

From an administrative standpoint, a tax on retail purchases could be administered within the existing framework of the Bureau of Internal Revenue organization. Ample precedent for filing returns and paying the tax exists in the present regulations relating to the selective retailer's excises, to which many retailers are already subject, and the social-security tax, which affects almost all retailers. In many cases, the total taxable sales for the year would be the same amount as the total sales shown on the retailer's income tax return. It is believed that a Federal tax on retail purchases could be collected without undue inconvenience to the taxpayer or the Government.

The State taxes on retailing prove that purchases at retail can be taxed readily and productivity. Some argue that because many of the States tax retailing, a Federal tax of the same type should not also be imposed. But no clear division in this respect exists even today. Several of the States also tax manufacturing, and the Federal Government already has a number of taxes collected directly from consumers, including the admissions tax. As a matter of fact, a Federal tax on retailing does not duplicate State taxes of this type to a greater extent than a tax on manufacturing, since both types of taxes are ultimately shifted to the consumer and, hence, constitute taxes on consumer spending.

To raise the maximum revenue while curbing inflationary consumer spending, the base of the tax on retail purchasing should include such services as those provided by barber and beauty shops, hotels, laundries, dry cleaners, repair shops, and certain other dispensers of service. Transportation and communication services are already being taxed. We do not have in mind the taxation of such services as those of architects, accountants, and attorneys, which are commonly employed in business, or those of the medical profession or of morticians.

To minimize the taxation of the lower incomes, purchases of foods in the retail markets to be consumed off the premises should be exempt. It is assumed that rentals for living quarters and payments for the purchase of homes would not be taxed. A large part of the typical family budget would thus be exempt from taxation.

The type of tax on purchases at retail which we propose should yield an annual revenue of approximately $1 billion at 1 percent and proportionally more revenue at a higher rate.

These are the several reasons why the Pennsylvania State Chamber of Commerce would prefer a general consumption tax at the retail level. Other witnesses appearing before you have emphasized the advantages of a tax at the level of final manufacture. We are encouraged to observe that businessmen are in general agreement on the present desirability of some type of broad-based consumer tax.

Let us consider some of the effects of the alternatives to a general consumption tax. If Congress raises a billion dollars by extending the system of selective excises and advancing the rates of certain existing excises, the lower incomes will probably bear the brunt of this commodity-tax increase. If the corporate income and excess profits taxes are advanced, much of this increase will presumably be shifted to consumers. Moreover, as the corporate and personal income taxes are raised, investment is penalized and economic incentives are dulled, to the disadvantage of production and employment. In whatever direction we may move to raise very substantial new revenues, we shall probably find we cannot escape the unpleasant necessity of going directly or indirectly to the only remaining source of such revenue, the incomes and spending of the middle and lower income brackets. We would prefer to go directly to that source with a general tax on consumer purchasing.

Heavier consumer taxation is one of the harsh requirements in this critical period, if we are to fight inflation as well as the Communists. But the inflation which inevitably would be engendered by deficit spending would be far more destructive of living standards and American institutions than higher taxes. There are no exemptions from inflation. It hits the poorest along with the richest. Food costs, rents, and the prices of everything purchased by the poor are advancing. We cannot escape the insidious inroads of inflation and its hidden, universal, and cruelly inequitable burdens unless we choose the lesser evil of heavier taxation of consumers.

If additional revenues must be raised, after consumer taxation has been increased to its rational limits, we would favor a higher tax on personal incomes.

But the tax increase in the House bill seems to us to be harsh and inequitable. We would prefer a flat increase of not over 8 percentage points on each bracket of surtax net income. More desirable, since the higher brackets already pay very steep taxes, would be to add any additional tax imposed as a flat-rate increase upon the income remaining after exemptions, deductions, and present income taxes.

We oppose the increased taxation of capital gains and the lengthening of the holding period for capital assets as measures which would discourage risk-taking and productive investment. As a general principle, we believe that capital losses should be recognized to the extent that capital gains are taxed.

After thoughtful consideration, we wish to register our opposition to the introduction of the proposed withholding taxes on dividends, interest, and royalties at this time. The enumeration of the dividends and interest received by the taxpayer on his return and the complete reporting by corporations of dividends distributed should first be given a fair trial.

As an organization of businessmen we are opposed to the proposed increase in the normal tax on corporations from 25 to 30 percent, resulting in most cases in an over-all tax rate, exclusive of excess-profits taxes, of 52 percent, retroactive to January 1, 1951. Even during World War II the maximum tax upon corporations not subject to the excess-profits tax was 40 percent. The proposed rate imposes an unconscionable burden upon productive enterprise.

We oppose the provision in the House bill reducing the excess-profits credit based on income from 85 percent of the taxpayer's base period average earnings to 75 percent of such earnings. The effect of such a provision would be to subject 25 percent of a taxpayer's admittedly normal earnings to an excess-profits tax, with a combined rate upon a portion of the income as high as 82 percent. We believe that such action is wholly unwarranted. In view of the continuing decline in the purchasing power of the dollar, it would be more realistic and equitable to increase the credit to 100 percent of average earnings. This would provide some measure of relief against the necessity of paying excess-profits taxes on mere inflated-dollar profits which do not in fact reflect any increased economic benefit.

The effect of these changes has been presented to you by Secretary Snyder (table 10), which indicates that a corporation whose present income is identical with that in the base period will be taxed 54 to 59.4 percent. This exceeds even the recommendation of a 55 percent rate proposed by the Treasury Department. Furthermore, the maximum tax upon every dollar of corporate income would be increased from 62 percent to 70 percent, leaving but 30 percent for capital expenditures, debt payments, and dividends.

We are opposed to the provision in the House bill which would allow only one surtax exemption and one minimum excess-profits credit to a related group of corporations. Many industries find it necessary to operate by means of two or more corporations under arrangements which were made years ago solely for business reasons and without regard to Federal income or excess-profits taxes. In such cases, each of the corporations is a valid, subsisting corporation. The proposed provision, however, would in practical effect refuse to recognize the separate existence of these corporations and to this extent would repudiate the corporate entity theory of taxation, which has been sustained in numerous court decisions. The allowance of a single credit to related corporations would be similar to the single credit now granted to affiliated corporations filing a consolidated return. Incongruously, however, the law exacts a penalty from those corporations which choose to file a consolidated return. If a provision of this type is necessary to prevent tax evasion, it should be aimed only at those whom it is intended to affect. We, therefore, recommend that if such a provision is found to be necessary, it should be applicable only to those corporate divisions which occur after January 1, 1951, and which are undertaken without a legitimate corporate business purpose other than tax reduction.

We believe that the first step to be taken in the amendment of the Excess-Profits Tax Act should be the correction of inequities which appear to be the result of errors in draftsmanship. Since these provisions should be corrected for the first year under the act, it is essential that the amendments be made immediately.

Taxpayers should not be required to elect at their peril to compute their excess-profits credit upon either the asset method or the historical invested capital method. No similar election is required as between the invested capital method and the income method, the code merely providing that the credit shall be computed upon whichever method produces the lesser tax. A similar rule should be provided with respect to the computation of credit under either the asset method or the historical capital method.

Section 435 of the Internal Revenue Code should be amended so as to allow a rate of 12 percent of the amount of net new capital addition for the taxable year in cases where the excess-profits credit is computed under the historical invested capital method. Such a credit is allowed to taxpayers using both the average-earnings method and the asset method of computing excess-profits credit, and a similar allowance should be granted to those taxpayers who use the historical invested capital method.

Sections 442 to 446 of the Internal Revenue Code should be broadened to provide a more detailed breakdown of industry groupings in cases where a substitute base period net income is to be computed by reference to an industry classification base period yearly rate of return. The present law provides that such base period rates of return shall be determined for approximately 60 major industry groupings. It is clear, however, that within any single industry group there may be a wide variety of subgroups for which there would be widely varying rates of return on total assets. As a result severe hardships will result to those taxpayers whose normally anticipated rates of return will be substantially higher than the average for the major industry grouping applicable under the present statute. Similarly, a distinct advantage will be granted to those companies whose normal rate of return is materially less than the average for the major industry grouping. This situation would be alleviated if the law provided for a more detailed breakdown of industry groupings for the purpose of applying the relief sections.

Section 435 (e) (1) (A) of the code should be amended by repealing retroactively to the first excess-profits tax year the requirement that for a corporation to compute its excess profits credit under the alternative "growth" method, its assets at the beginning of the base period may not exceed $20 million. Corporations of all sizes which were growing rapidly during the base period need a growth credit to equalize their position as compared with other corporations of equivalent size which achieved their growth prior to 1946. Clearly, a growth formula based upon any predetermined level of assets will not afford a fair measure of the need for relief.

The inadmissible assets factor should be applied to reduce the taxpayer's invested capital rather than its excess-profits credit. The purpose of the inadmissible assets factor is the elimination of that portion of the taxpayer's assets the income from which is not subject to the excess-profits tax. This elimination, therefore, should properly be accomplished by a reduction in the invested capital upon which the excess-profits credit is to be based, rather than upon a reduction of the credit itself. We, therefore, recommend that the World War II law treatment of inadmissible assets be followed in the present excess-profits tax law.

The present House bill removes the long-standing unfairness of applying the income tax to taxpayers who sell one residence and purchase another. There are other provisions of the income tax law which also should be corrected. Among them are those relating to the taxation of foreign investments and business operations in foreign countries. The provisions relating to the foreign tax credit should be liberalized in order to encourage foreign trade and investment. Under the existing provisions of section 131 (f), the allowance of the foreign-tax credit is unduly limited to certain restricted situations. Thus, under section 131 (f) (1), the credit is allowed only where the domestic corporation owns a majority of the stock of the foreign corporation. Under section 131 (f) (2), the credit is allowed only in those instances where the foreign parent owns 100 percent of the foreign subsidiary. It is recommended that the provisions of section 131 (f) (1) be liberalized to permit the allowance of the credit in all cases where a domestic corporation which owns any stock of a foreign corporation receives dividends from the latter. The provisions of section 131 (f) (2), relating to a foreign subsidiary of a foreign corporation, should be amended so as to allow the credit in cases where the foreign parent owns less than 100 percent of the voting stock of the foreign subsidiary. We suggest a requirement of 20 percent ownership.

The 2 percent penalty upon the filing of consolidated returns should be repealed. As a result of increased rates, this penalty would take an increased percentage of retained earnings. Consolidated returns have been provided for in the tax laws since 1921, as a means of determining the net income of a single enterprise, even though the business is carried on through two or more corporations. No special advantages are derived through the use of such returns. They are recognized and favored by both the Treasury Department and taxpayers alike, as the only practical method of determining net income in such cases, and as a method which is fair and easy to administer. The additional rate of 2 percent imposed upon those filing consolidated returns, however, imposes a penalty upon their use which in many cases compels the filing of separate returns. Such a provision clearly discriminates against the business which must be carried on through subsidiaries. Considered either from a viewpoint of equity or administrative convenience, consolidated returns should be fostered by eliminating the 2 percent penalty imposed on their use. In addition, and in any event, the taxpayer should be given by statute the right of an annual election to file either consolidated or separate returns, in place of the present restrictive provisions contained in the regulations.

Sections 165 and 23 (p) were originally designed to cover voluntary pension plans set up by employers. In the last 2 or 3 years many pension and welfare plans have been set up pursuant to negotiated contracts with labor unions. In an effort to apply sections 165 and 23 (p) to these negotiated pension plans many complications have arisen, particularly with respect to the limitations on deductions under 23 (p). Where employers set up trusts to cover their liabilities under agreements with labor unions, there would seem to be no question but that the contribution made to such a trust should be deductible. In order to provide for this new situation, it is suggested that a new provision should be inserted in section 23 (p) which would permit employer companies to deduct all amounts paid into a trust for the purpose of funding their liabilities under negotiated contracts with labor unions.

We appreciate the opportunity which has been extended to us to appear before your committee.

Senator BYRD. At the request of Senator McClellan, of Arkansas, here is an insertion to be made, coming from C. H. Scott, of Little Rock, Ark.

(The document referred to follows:)

LITTLE ROCK, ARK., *August 1, 1951.*

Re Titanium—Special tax treatment on same basis as granted other strategic and precious minerals that are so essential to furtherance of defense efforts.

United States Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR: Every group interested in any particular mineral, oil, or businesses of any kind from a purely selfish standpoint naturally try to get as much tax consideration as possible, quite often to the detriment of other groups. Those interested in the production of titanium are interested in seeing that this mineral receives the same equal treatment pertaining to taxes as any other strategic mineral that is used in the furtherance of our defense efforts.

I doubt if there is another mineral that is occupying as much spotlight from and by the chemists, metallurgists, corporations, with research laboratories and the Government as is now found in titanium. This is particularly true in trying to find a process that will refine the ore into finished metal that is so badly needed for military uses by Army, Navy, and Air. The finished metal will play a great part in making our military equipment lighter, more efficient, stronger and effective as well as many other uses in our over-all economy.

We feel like your committee might want to make a distinction and give special treatment on any titanium which is refined into metal that will be used for and in the development of our military power. We use approximately 750,000 tons of ilmenite that is produced in this country and some foreign countries and practically all of this is used in paint by Du Pont, National Lead, Kenecott Co., and other companies. I doubt if Congress would want to make any special treatment on any titanium that is used in this manner but, on the other hand, I think when titanium in any form is refined into metal by any process that will make it cheap enough for the Government to use in strengthening our military equipment it should have special treatment the same as lead, zinc, tungsten, bauxite, barite, etc.

I want to take the liberty of asking the committee to study several recent articles by men and research laboratories who have devoted a great deal of time to improving and perfecting a process in making it possible for titanium to compete with aluminum, stainless steel, and other metals.

Exhibit No. 1: New Wonder Metal: Titanium. Condensed from Popular Science Monthly, Harland Manchester, published by the Reader's Digest, October 1950.

Exhibit No. 2: Potential Uses of Titanium Metal—Military Uses, by C. C. Ralston and F. J. Cservenyak, Bureau of Mines, Washington, D. C., published by Industrial and Engineering Chemistry, February 1950.

Exhibit No. 3: Release from Washington, D. C., July 2, 1951, appearing in Arkansas Gazette, July 3, 1951, pertaining to new process developed by Horizons, Inc., Cleveland, Ohio.

Exhibit No. 4: Titanic Titanium, article appearing in Business Week, July 21, 1951.

Exhibit No. 5: Excerpts from statement prepared by Felix A. Vogel, Jr., of the Bureau of Mines, dated September 1944, pertaining to titanium properties.

Some remarks by Dr. R. G. Knickerbocker, Chief of Minerals Technology Division Region VI, Bureau of Mines, Rolla, Mo.

Remarks by M. E. J. Chapin, Metallurgy Division, Naval Research Laboratory, Washington, D. C.

Exhibit No. 6: Statement by Helena M. Meyer, Bureau of Mines Minerals Yearbook 1949, Titanium.

It is the consensus of opinion by and among the chemists and metallurgists that different forms of titanium will ultimately be used in metal which will be produced in abundance by and through an easier process, which will be developed by some research laboratory or pilot plant.

We feel that this special tax treatment should apply to ilmenite, rutile, or any other form of titanium that will actually go into metal used in the development of our military equipment.

There are only three or four substantial known deposits of rutile in the United States. It is the consensus of opinion of men who have studied these deposits that the largest one in this country is at Magnet Cove, Ark. There could be 8 to 9 million tons of titanium (rutile).

I think this special tax treatment we are requesting would strengthen our hands in the development of these deposits, especially if and when a new process is finally perfected to the extent that the raw titanium can be refined into abundance of finished metal.

Any courtesy that your committee can extend in meeting our request will be greatly appreciated.

Sincerely yours,

C. H. SCOTT.

[From the Reader's Digest, October 1950]

NEW WONDER METAL: TITANIUM

(By Harland Manchester—Condensed from Popular Science Monthly)

A few years ago Dr. Charles H. Moore, Jr., a young industrial-research scientist of Perth Amboy, N. J., made in a small furnace of his own design a pear-shaped crystal of titanium oxide the size of his thumb. He was working with titanium to try to make white paint a little whiter, and eventually he succeeded. But as he looked at the crystal he got another idea. He took it to a lapidary, who cut and polished it. The result was an amazingly beautiful gem, not quite as hard as a diamond but far more brilliant.

Thus the first really new gem in history was born. Unlike synthetic rubies and emeralds, "titania" or "rutile" is not an imitation of anything. It is a gem in its own right. National Lead Co., Dr. Moore's employer, operates six furnaces to make the crystals and sells them to gem cutters all over the country. Thousands of women are proudly displaying them. Most titania stones are white, but they are also made in rich blue, orange-brown, red, green, and yellow. They sell for about one-thirtieth the price of diamonds.

This new gem is only one facet of the great titanium development which many scientists, manufacturers, and military men are excited about. They predict that titanium, light, strong, and rust-resistant, will become a major metal, rivaling in importance aluminum, magnesium, and stainless steel.

Better and faster planes, more powerful jet engines and gas turbines, lighter and more durable automobile engines, ships that need no paint, long-wearing and nonrusting edged tools, cool handles for kitchen pots and pans, better optical lenses—these are a few of the things that titanium in its various forms may bring about.

The new metal is a natural for airborne vehicles and weapons, since its use instead of steel cuts weight 40 percent with no sacrifice in strength. Army Ordnance, testing the new metal for tanks, finds that it resists penetration better than steel of the same thickness.

From the Navy point of view, this silvery metal is highly desirable because it is virtually rustproof. Samples of titanium immersed in the sea for 60 days showed no trace of corrosion—a record equal to that of platinum, the noncorroding champion. The prospect of decks which need no paint and of cabins and other seagoing gear which never rust is tremendously cheering to naval men. The metal is also unaffected by many highly corrosive acids and alkalis, and its resistance to vinegar, citrus juices, and other corrosive foods makes it eligible for kitchen containers.

Titanium has the great merit of being plentiful. It is the ninth most common element in the earth's crust, far more plentiful than nickel, copper, or lead. Also it is the fourth most abundant structural metal, exceeded only by aluminum, iron, and magnesium. This does not mean that our factories can start using the metal tomorrow. Production is yet in the pilot-plant stage. But in scores of Government, university, and industrial laboratories, a concentrated drive is under way to harness this versatile and long-neglected element. In the last 4 years Government and industry have spent more than $15,000,000 on titanium research, and belief is common among experts that it will become a major structural material within 5 or 10 years.

Titanium is by no means new. The ore was first discovered about 160 years ago by William Gregor, an English clergyman and amateur chemist. Martin Heinrich Klaproth, famous as the discoverer of uranium and other elements, rediscovered titanium in an ore called ilmenite, announced it as a new element, and gave it its name.

The first big-scale use of titanium developed indirectly from the fact that a French chemist named Auguste J. Rossi was something of a gourmet. He was employed in the laboratory of the Titanium Pigment Corp., Niagara Falls, N. Y., which produced titanium oxide to improve the whiteness of false teeth, billiard balls, and other articles. He always brought his lunch to the laboratory, and there mixed his own salad dressing. Spilling some olive oil on his workbench one day in 1908, he noticed how it mixed with the titanium. Thereupon he began research into the possible use of the oxide as a paint pigment. The result many years later was the whitest white paint ever known. The tiny crystals are highly efficient reflectors of light, hence titanium paint has great opacity or "hiding power." This means that a little of it will cover a lot of surface. A dash of titanium oxide is used by the Johns-Manville Corp. in the manufacture of a long-lasting white asbestos-cement siding for houses.

Titanium oxide has largely supplanted white lead in paint. It is also used in whitewall tires, white rubber bathing caps, kitchen-equipment enamels, face powders and creams, and many other products. Some 225,000 tons of titanium oxide are now used every year to make white things whiter.

Dr. Wilhelm Kroll, of Luxemburg, 18 years ago invented a promising process for extracting the pure metal from the ore. When he fled to the United States in 1940 to escape the Nazis the Bureau of Mines signed him up. A pilot plant was set up at Boulder City, Nev., and by 1946 the Bureau was making the new metal—spongy gray stuff which looked like oversize furnace clinkers. The Bureau set up another pilot plant at College Park, Md., to fabricate the metal into bars and sheets and to work on alloys. At this time world production of the metal ran about 10 pounds a year. Today United States production is in the neighborhood of 40 tons annually, enough for large-scale experiments. Having nursed the new metal to the toddling stage, the Bureau is now turning it over to industry.

Discovery of superior new titanium alloys will hasten its adoption. The pure metal is strong and stable up to 800° F. Tests indicate that the right alloys will push this ceiling far higher. When the alloys become available aviation experts foresee a possible 20 percent reduction in the weight of airplanes, which would more than double the plane's pay load of passengers, freight, fuel, or bombs.

When titanium was used only for pigments we got most of it from the black-sand beaches at the southern tip of India. Now geologists report such widespread distribution of the ore throughout North America that we can be completely independent of imports. From a huge, terraced, open-strip mine at Tahawus, N. Y., titanium-bearing ilmenite is being scooped up by National Lead Co. The Kennecott Copper and New Jersey Zinc Cos. are jointly spending $25,000,000 to open up a tremendous ilmenite deposit in the Allard Lake region of Quebec. Du Pont and other firms are getting titanium from the sands of Florida beaches.

As for titania, the gem with more fire than a diamond, its fascinating possibilities are not limited to jewelry. Because of its superior light-gathering ability, it has important optical uses. As bigger crystals of optical purity are made, titania lenses might make possible powerful small telescopes, smaller periscope tubes, smaller tubes for internal physical examinations. A research job in this field has been launched by Bausch & Lomb. Titanium also has interesting electrical properties. Tiny wafers of barium titanate are used in place of crystals in hearing aids, radios, radar, and television sets, and record players.

Whatever other uses may be found for the new metal, you may be sure there is titanium in your future.

[Reprinted from *Industrial and Engineering Chemistry*, vol. 42, p. 214, February 1950]

Potential Uses of Titanium Metal

(By O. C. Ralston and F. J. Cservenyak, Bureau of Mines, Washington, D. C.)

Potential uses of titanium are based on the favorably combined properties of high strength, light weight, and resistance to corrosion. Uses of titanium as disclosed by the literature and reported by those who are actually testing its suitability for numerous purposes are cited. The field of usefulness by the Army, Navy, and Air Force is given. Although this relatively new metal with unique and highly desirable properties has a promising future, its production today is too costly to warrant the conclusion that it will have almost universal applications and compete with steel, aluminum, and copper where these cheaper metals can function satisfactorily.

Titanium, a metal inadvertently but correctly named after the Titans, may naturally be expected to have many uses. As a pure metal it is unusually strong, and because it has a specific gravity only a little over half that of steel it has the advantage of exceptionally high strength-weight ratio—the real basis of comparison. Another great advantage is its corrosion resistance, which places titanium in the same class as the stainless steels. It is obvious, therefore, that the biggest immediate field of usefulness is in aviation, where high strength, light weight, and resistance to corrosion are all important. The same applies to marine conditions, but the necessity for getting nothing but top quality is not so pressing.

This paper gathers some details on the uses of titanium as disclosed by the literature and reported by those who are actually testing its suitability for numerous purposes. Many of the potential uses have minor importance as far as amounts of metal are concerned, but everything taken together indicates a promising future for enterprisers.

The Bureau of Mines pioneered and developed the first commercially adaptable process for the production of high-purity titanium metal. It has been the Bureau's policy to distribute new products to qualified technical and scientific organizations to expedite industrial interest and exploitation. This practice has accelerated commercial development in the case of electrolytic manganese and is doing the same for titanium.

The potential uses of titanium are based mainly on the favorably combined outstanding properties of high strength, light weight, and excellent resistance to corrosion. Its development should have an important bearing on the future welfare of the Nation not only as a substitute for presently used strategic materials in short domestic suply, but also for construction materials having a combination of properties not possessed by other available metals and alloys.

It is estimated (*4*) that titanium is the fourth most plentiful metallic element in the earth's crust suited for structural uses. Commercial ores of titanium are widely distributed in the United States and the cost of developing them has been charged in part to the titanium-oxide industry, which, up to the present, has been the main use for titanium. The titanium industry has been featured year after year by the record-breaking consumption of titanium dioxide in pigments for paints, the only large quantitative use (*17*). Production of the oxide, therefore, has provided excellent sources of ore for the development of the metal.

INDUSTRIAL USES

The availability of high-purity titanium will advance its use far beyond prior applications where alloys or impure titanium metal have been previously utilized. These prior uses are well known and include ferrotitanium as a scavenger or purifier for steel, as a primary precipitation hardening element, and as a ferrite former (*22*). In the form of ferro alloys, titanium is used as an alloying element in austenitic stainless steels (*23*) to stabilize carbon and prevent intergranular corrosion. It is also employed in heat-resisting alloys, weld-rod coatings, and in permanent magnets (*11*).

Titanium belongs to that class of elements that causes unmixing when added in small amounts to melts of iron and ferrous sulfide, converting the ferrous sulfide into titanium disulfide (*25*) similar to the action of manganese.

The metal is principally used in steel because of its property of forming stable carbides and nitrides; it acts also as a deoxidizer. Steel with a titanium content of only 0.02 percent reduces the equilibrium oxygen content in a melt just as much as 0.2 percent silicon (*29*).

Titanium is claimed to be suitable for use in chromium-free, heat-resisting steels (*26*). It was also found most effective in a group of alloying elements used to reduce grain size in high-chromium, heat-resistant steel (*24*).

It was found possible to get high creep-strength values for certain steels containing titanium (*9*). In low-carbon steels tested for high-temperature use, it is believed that titanium will prevent hot shortness due to sulfur and that, therefore, manganese above the usual residual content of about 0.15 percent is unnecessary (*5*). The addition of titanium stabilizes enameling iron (*27*) and steel (*6*) by converting the carbon to a more stable form. Most defects in the vitreous enameling iron result from reaction of an iron-carbon aggregate with the molten glass. Addition of titanium in enameling steel stabilizes the carbon and stops its reaction with the oxides in the enamel coating that forms gas and blisters.

Porosity is eliminated in monel castings by use of titanium to combine with the hydrogen and nitrogen. In aluminum alloys, titanium acts as a grain refiner and strengthener.

Small quantities of titanium added to copper or nickel give strong age-hardening alloys which may be utilized as a substitute for tin (*16*). At 900° C., titanium spreads in a thin layer over copper surfaces, which suggests the titanizing of ferrous plates that have first been given a copper coating.

Titanium forms extremely hard nitrides and carbides, the latter being useful for special cutting tools.

A high-temperature, 70-percent-nickel alloy, Inconel X, uses titanium now introduced as ferrotitanium. The availability of unalloyed pure titanium low in nitrogen and oxygen might mean that 7 to 10 percent titanium could go into the production of this alloy (*14*). Inconel X possesses outstanding spring characteristics at elevated temperatures and may have application in the gas turbine and jet engine fields.

Tests indicate that addition of titanium decreased grain size and increased flexural strength of cobalt silumin and manganese silumin (*12*).

The gettering or gas-absorbing property of titanium is well known. Gases such as oxygen, nitrogen, carbon dioxide, etc., are absorbed by titanium in the production of high-vacuum tubes. Chips of titanium can be used to remove oxygen and nitrogen from helium and argon.

During World War II there was considerable interest in Germany on certain potential uses of high-purity titanium (*21*). In the vacuum tube industry, tests were conducted with pure titanium in sheet form for use as functional elements and as getters. Addition of the metal to certain steels seemed to enhance their high-temperature resistance properties and to lower their creep rates. Some of the German work included cladding steel with high-titanium alloys of copper, nickel, and cobalt to provide fairly good heat-resistant surfaces. It was also indicated that light armor plate might be prepared by incorporating titanium into a steel surface, followed by carburizing and heat treatment. Preliminary experiments indicated that laminated plate formed from sheets of titanium showed promise for this purpose. Consideration was also given to the application of titanium in jet-propulsion aircraft. It was thought that the metal might have useful applications in the production of mirrors because of its excellent resistance to corrosion and condensation. A very thin layer of the ductile metal was evaporated onto a glass surface to make such mirrors.

A low-carbon German steel with 0.5 percent titanium was used (*1*) as sheet material in jet planes for high-temperature service and for turbine wheels. It was reported (*3*) that when small amounts of titanium were added to Thomas steel, the product could be used to make machine gun barrels.

The German war metallury (*15*) brought out a type of alloy that was protectively chromized by gaseous chromous chloride or chromic chloride. Various basis metals were chromized most effectively and an important type was a steel-containing titanium.

The influence of titanium as grain refiner is evident in all of these processes. In one instance, the titanium proportion is definitely specified to be less than enough to combine with the carbon content of the steel. High-temperature creep strength was attained by hot-working the metal above 1100° C. A heat treatment for titanium-bearing chromized steel was also described heating at 500° to 900° C. and then quenching in air, water, or oil. Products manufactured from such steel were heat- and scale-resistant and good for exhaust parts of internal combustion engines.

Pearlitic nickel-vanadium steel with less than 0.2 percent carbon, up to 1.5 percent vanadium and 1.8 percent nickel (in which the vanadium could be replaced by titanium) was corrosion-resistant and had high impact strength at lower temperatures. It was designed for vessels and tubing for refrigerator coolers. It is claimed that a basis metal of austenitic manganese steel with 12 to 22 percent manganese and under 0.2 percent carbon should contain a grain refiner like titanium, zirconium, vanadium, or molybdenum to impart resistance to corrosion at high and low temperatures when chromized, high hot strength, toughness, and high fatigue strength.

The phenomenon of marking glass with pure titanium is well known. The glass should be clean and free of grease or oil, and if it is wet with a mild alkali it is possible to draw consistent lines without pressure. The mark is essentially a streak of smeared titanium, but the surface is also scratched, as can be noted by dissolving the metal with dilute hydrofluoric acid. Many minute scratches are formed transverse to the direction of marking. Rubbing titanium metal against other hard surfaces often produces smears which are difficult to remove. Such smears have been investigated (28) on diamond, corundum, hematite, magnetite, rutile, chrysoberyl, spinel, quartz, topaz, diopside, beryl, albite, axinite, epidote, garnet, and tourmaline. Titanium smears can be used to make high electrical resistances by marking glass with a metal point or pencil.

The smearing of titanium parallels the seizure of aluminum in the early days of experimenting on aluminum engine blocks and pistons. That difficulty was cured by alloying and heat treatment. Therefore, any trouble that might be encountered with pure titanium under similar conditions or in operating titanium shafting against bearing metals should not indicate that all forms of the metal are unsuitable for such purposes.

The combination of stainlessness, high proportional limit, and low modulus makes titanium an interesting material for springs where a considerable expansion in relatively low loads is required. Main and hair springs for watch and clock products may be improved by replacing the steel wire now used with titanium. Titanium or alloyed titanium hair springs may be used in control equipment such as time devices for water softeners that are usually installed in basements, which in many cases are damp, and give trouble due to rusting of the hair spring.

Titanium has been suggested for use in boiler and boiler-feed-water systems as replacement for 18-8 stainless steel, which is about the only metal resistant to high purity and aerated water. Some suggested uses for titanium in the boiler plant include valve seats, corrugated gaskets, and pump parts. In applications where titanium proves insufficient, consideration should be given to its sister metal, zirconium. Since titanium resists attack by dilute sulfuric acid and also by concentrated acid, especially in the range of 40 to 60 percent, it might be used in recuperator elements for preheating air in power plants. Some of these elements are alternately exposed to temperatures ranging from below the dew point of the flue gases to 1000° F., and there is a tendency for condensation and absorption of sulfur dioxide from the flue gases, forming acid in varying concentrations, which attacks the metal. The thin oxide film which will form at the maximum temperature might be of assistance in resisting the acid attack. It is hoped that titanium can be used for measuring chambers and for powdered-metal gears in water meter gear trains, both of which suffer greatly from corrosive waters.

A small percentage of titanium is used in steel tubing at a steam power plant (8) to superheat steam from 850° to 1050° F. in the last two stages of a three-stage system.

It is believed that titanium can be used as a rotary shaft seal operating in fuming nitric acid because of its chemical resistance to this acid and its possibility of resisting frictional wear. The resistance to frictional wear, mainly dependent on the service conditions, may be increased by surface hardening in a cyanide bath (7) or introducing oxygen by heating under controlled conditions. Temperature control is necessary to obtain the desired surface hardness without scaling. The ability of titanium to be surface-hardened suggests its use for parts subject to frictional wear, such as cutting tools, dies, bearings, pistons, cylinders, and other engine components (8).

Titanium appears to have a future in the design of portable machine tools where strength and light weight combined with a definite proportional limit are desirable. It is also being considered for use in sensitive geophysical instruments.

Titanium powder, with its sister metal, zirconium powder, has been used experimentally in a low-melting alloy matrix in producing sparking flints for cigarette lighters. Experiments showed that a satisfactory flint can be produced as a substitute if cerium or misch metal became scarce. The pyrophoric properties of these flints are satisfactory, although their softness leads to rapid consumption.

An optical firm is experimenting with titanium evaporation onto glass surfaces to produce high-index films. Successful tests have been made on sealing hard glass to titanium wire by an electronic tube manufacturer. Because of its wetting properties, titanium has found use in an alloy for sealing window glass to metal frames (*23*). Approximately 2 percent titanium is preferred in a copper alloy (*13*) used in metalizing glass. The alloy is easily atomized into droplets small enough to eliminate largely local shattering of glass by droplets of hot metal.

It has been estimated that there are 12,000,000 orthopedic patients in this country, of whom 2,000,000 wear full braces. Because of its light weight titanium could replace stainless steel in the manufacture of such braces. It is also believed that titanium might have a place in the prosthetic dentistry field in making stronger appliances for the mouth. Titanium may be used for medical and dental equipment where strength and freedom from corrosion have prime importance.

Preliminary tests indicate that titanium would be satisfactory for metal coil springs in oviduct diaphragms. It has been suggested for spectacle cases where strength and light weight are required. It is claimed that aluminum cases are too soft and steel cases too heavy. The extra cost of titanium is compensated by the added protection given in rimless glasses. Titanium should also be useful in making fancy frames for women's glasses. Although aluminum frames are light, they reportedly become dull and lose their polish. In cutting lens shapes the glass blanks may be marked with a titanium pencil. The special inks now being used for marking glass blanks come off during handling and edging.

Corrosion studies with various foods (*10, 19*), such as pineapple juice, cider vinegar, lard, tea, coffee, grapefruit juice, and lactic acid showed no attack on titanium. This suggests that titanium could be used for food handling and processing equipment in restaurants and lunch counters. Its low thermal conductivity indicates many possible household uses, such as handles for pots and pans.

The development of titanium may be an important contribution to the electronic industry for making miniature capacitors of smaller size than now obtainable. Tests have been made on oxidizing the surface of titanium to a thickness of 0.5 mil of oxide and by firing a silver film on the exposed side in nitrogen atmosphere. It was reported that higher capacities per unit volume of the composite metal and oxide were produced than is possible using ceramic material.

X-ray targets of titanium have been prepared and have proved to be satisfactory in practice, showing no signs of deterioration. Only a thin layer of titanium is necessary on a water-cooled copper base because of the low thermal conductivity of titanium. A considerable reduction in the amount of scattered radiation is indicated by the use of titanium radiations in X-ray diffraction photographs.

It is believed that the intensity of radiation from a synchrotron may be increased by enclosing barium aluminate in a titanium foil jacket with a heater buried in the center. There is reason to expect that the barium, which diffuses through small holes punched in the titanium, will condense on the surface of the titanium and provide a greater source of electrons than can be obtained from a pure tungsten or a coated filament that can be provided in the available space.

The stability of the discharge in lamps is greatly improved by the use of titanium electrodes (*20*). Titanium may also be used as a capacitor electrode material and as an electrode for disintegrator drills.

Interest is also being shown in titanium for the fabrication of thin-window Geiger tubes for counting beta particles and in a radioactive isotope of vanadium which may be conveniently obtained from a titanium target by deuteron bombardment.

Titanium should find use in textile machinery (*8*) for high speed, light-weight spindles, spools, warp beams, and other working parts. It may be used for sporting equipment such as light-weight noncorroding golf clubs, tennis racquets, and fishing rods. Its corrosion resistance, together with its ability to surface-harden, is being utilized in making pen points and styluses.

MILITARY USES

Potential applications of titanium by the Army, Navy, and Air Force were reported at a recent symposium on titanium sponsored by the Office of Naval Research.

The property most attractive to the Navy and Air Force is the outstanding resistance of titanium to corrosion by sea water and saline atmospheres. Corrosion tests on titanium in sea water have shown scarcely any effect on the metal and indicate that titanium is more resistant to salines than any common engineering material. The life span of naval equipment subject to corrosion could be greatly prolonged by the use of titanium (*30*), and this metal would thus compete economically with materials now produced at a lower cost. Numerous possibilities exist for the use of titanium on ships. Possible applications are for lightweight piping systems handling salt water, condenser tubes operating with high water velocities, replacing Monel or stainless steel in plumbing fixtures, substituting for stainless steel in pump rods or rotor shafts, and for water-lubricated and antifriction bearings of high load capacity operating in salt water. Titanium wire may be used for shipboard radio aerials if tests prove that it is resistant to stack gases. Small, high-speed propellers may be made from titanium if satisfactory resistance to hydraulic cavitation is shown. To date, few, if any, alloys tested have better corrosion resistance than pure titanium for the above applications.

Numerous applications of titanium for aircraft are now being considered (*18*), the majority of which involve substitution of titanium for other materials in structures where intermediate temperatures, weight, or corrosion problems are encountered. Where a high strength-weight ratio or esistance to salt water corrosion is required, titanium could be substituted for lightweight alloys and steel. At high speeds the organic protective coatings on leading edges made of light alloys are removed by dust and rain impingement, and the efficiency of the airplane is decreased because of increased turbulence and drag resulting from roughening of the edges.

The present high-strength light alloys begin to weaken at temperatures between 300° and 400° F. Elevated temperatures are becoming more common in aircraft as a result of aerodynamic heating at high speeds, use of heat for deicing, proximity of structural parts to jets and afterburners, and higher temperatures in the compressors of jets and turbines. Titanium is preferable to steel for moderate-temperature service because of its lightness and corrosion resistance.

Titanium has also been suggested for special aircraft applications, such as high-speed hot-air heater wheels, armor plate, electrical components, pontoons, cables, structural braces, wing coverings, and fuselage construction.

Army engineers are interested in titanium for such equipment as truck bodies, girders, and other members of portable bridges. Air-borne equipment used by future armies undoubtedly will utilize light-weight, strong titanium advantageously.

The following quotation from a letter from the Office of Chief of Ordnance, Department of the Army, will show the vital interest of the Armed Forces in uses of titanium:

"The Ordnance Department, Department of the Army, is intensely interested in the potential uses of titanium metal for military applications. In the past it has directed its efforts in research and development to the more basic problems, such as preparation of equilibrium diagrams for the most promising alloys, effects of impurities, and other metallurgical investigations. It will continue to emphasize the more fundamental aspects of this research to the utmost of its capabilities to provide data urgently needed in the development of titanium alloys.

"The Ordnance Department is particularly interested in the use of this metal as a replacement for other metals where light weight, high strength, hardness, corrosion resistance, shock resistance, etc., are required. Ordnance equipment of the future is pointing more and more toward air transportability. The over-all weight of equipment which the foot soldier must carry into battle must be reduced to render him more effective. The combat man must have more effective protection with lighter weight against whatever missile the enemy might employ.

"In order to accomplish these objectives, the Ordnance Department must depend largely upon industry and others to devote as much of their efforts as possible to perfecting economical methods for reducing titanium ore and producing the metal; the proper alloying of titanium metal to secure maximum toughness, hardness, strength, resistance to impact, corrosion resistance, etc.; and appropriate welding techniques and fabrication procedures for the various alloys which may be developed.

"The apparent advantages to be gained by the use of titanium in military equipment are so marked that the significant future improvement of equipment may well be predicated on an early solution to the problems outlined above."

CONCLUSION

Commercially pure titanium is a new base metal whose alloys have not yet been developed. Extensive development and testing are now being conducted on high-temperature alloys. The study of alloys based on titanium is still in its infancy, and some very useful alloys may be developed that will be as far superior to the pure metal as stainless steel is to iron. When the essential information on titanium alloys is available, the usefulness of the new metal can be fully evaluated. Although considerable progress in alloying is being reported, the results are not conclusive enough to permit making definite recommendations. Commercially pure titanium is a very good metal for a wide variety of uses, but alloying might greatly improve it and increase its advantages. The principal improvements noticed in alloying have been in its strength rather than its corrosion resistance.

From certain articles that have appeared in newspapers and the popular press one might be led to believe that titanium is destined to replace the better-known structural metals and have almost universal applications.

Although this relatively new metal has unique and highly desirable properties, its preparation today, even with the advances made in its recovery from natural sources, is too costly to warrant the conclusion that it will compete with steel, aluminum, and copper for purposes where these cheaper metals can function satisfactorily.

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[From the Arkansas Gazette, July 3, 1951]

Cheaper Method of Making Titanium Revealed by Navy

Washington, July 2.—The Navy announced today it had developed a process which it expected to reduce by 80 percent the cost of producing titanium, a light, strong metal. One pound of sponge metal which formerly cost $5 can be obtained now for $1, the Navy said.

Titanium is used in jet and gas turbine aircraft and for component parts in ship construction. It is being tested for possible use as a skin over air frames, for wing edges and jet plane ducts. It is 70 percent heavier than aluminum and six times as strong.

The new process was developed by Horizons, Inc., at Cleveland, Ohio. The pilot plant stage in the new production method has been reached.

Successful commercial production of titanium and titanium alloys at the new low cost is expected to fulfill heavy military demands for a light metal of that type. The Navy said that the lower cost should lead to extensive use of titanium in the production of civilian goods.

[From Business Week, July 21, 1951]

Titanic Titanium—New Metal Has Vast Potential if Cheap Production Method Pans Out, But Fabrication Woes May Delay Its Spread

Horizons Titanium Corp. is looking out at some very broad horizons. A 100-million-pound-a-year market for titanium, for instance—the sober guess of a Government authority.

Prospects for that sort of military and commercial demand hang on the big-scale production success of Horizons' new process for making titanium (Business Week—July 7, 1951, p. 20). So far, the Horizons process is in the test-tube stage. But the company is betting that it will be able to bring the cost of titanium down to $1 a pound, from the present cost of $5 a pound for sponge and $7 a pound for ingot.

Titanium enthusiasts see almost no limits to the expansion, if the price can be chopped down. They point to the case of aluminum, which conquered enormous markets as soon as the price was right.

Fabrication.—Of course, no new metal comes into mass use overnight. Once it's established that it has the desired properties, you have to lick the problems of extraction. That's what Horizons believes it is doing now. But success there is not the end; you also have to learn how to fabricate the metal. That knowledge comes from experience alone. And in the case of titanium it promises to be a long job, for the metal is hard to work.

The virtue of titanium lies in its combination of three properties—strength, light weight, and corrosion resistance. It's about twice as heavy as aluminum and four times as strong, less than half the weight of stainless steel and almost as strong. In certain places, like salt water atmospheres, titanium will resist corrosion better than aluminum or stainless steel.

Pots and pans.—Some enthusiasts feel that low-priced titanium could crack the pots-and-pans market. Although it is heavier than aluminum, thinner sections could be used because it's stronger. Titanium might move in even faster in places like railroad car structural parts, auto bright work and trim, and chemical processing equipment like valves and piping.

Unlike private industry, Government goes ahead on a cost-doesn't matter basis when it feels that a material is vital. That's why it is using titanium even at present prices, in relatively small quantities for research and prototypes. If titanium's price should drop from $5 to $1 per pound, the services would rush to put it to work in lots of places where it is desirable, but not wholly essential. Here are some of these military jobs for $1 titanium:

Aircraft.—There are many promising uses in jet and gas turbine engines. Titanium has withstood tests in firewalls, shrouds, baffles, and diaphragms, where its big advantage over stainless steel is in weight saving. A 0.015-inch thick sheet of stainless weighs 0.60 pound per square inch; a titanium sheet of the same thickness weighs only 0.35 pound per square inch. Titanium alloys might also stand up in blades for jet engines, provided they aren't subjected to excessively high temperatures. Using titanium instead of stainless steel might lighten a jet engine by as much as 300 pounds. That's equivalent to about 50 gallons of fuel.

Naval uses.—Titanium's resistance to salt-water corrosion makes it a natural for shipboard use; the Navy is hot about Horizons Titanium's new process. Brine has been known to attack stainless steel in certain cases; titanium can stand the gaff. A few parts that the Navy would like to make of titanium are: snorkel tubes for submarines, valve seats, heat exchangers, condenser piping systems, pump shafts, small propellers and propeller shafts, and steam turbine blading.

Ordnance.—Army Ordnance wants to use titanium in applications involving manual handling because of its lightness. A case in point is the 81-millimeter mortar base plate, where it has been shown that titanium can be used instead of steel. Made of titanium, the plate can be of one-piece construction weighing about 24 pounds. The standard steel plate is made in two pieces, each weighing 24 pounds and each carried by one man. The rest of the weapon is carried by a third man. With the titanium plate, the mortar can be handled by a two-man crew.

Armour plate.—Col. Benjamin S. Mesick, Chief, Reserve and Materials Branch, Army Ordnance Research and Development Division, recently said that titanium alloy may possibly be substituted "thickness for thickness for alloy steel armor, reducing armor weight by about 40 percent."

Hard to work.—Actually, reducing the cost of titanium is only a part of the problem. Right now the material isn't too easy to work. It's tough to machine and is rough on grinding wheels. But there shouldn't be too much trouble in welding, forging, or extruding titanium. In rolling sheet and strip, the material will have to be hot-worked, probably followed by a cold finishing operation.

Present fabricating experience with titanium is limited. But specialists say that when more is learned about its characteristics it should be comparable to stainless steel in workability.

EXCERPTS FROM STATEMENT PREPARED BY FELIX A. VOGEL, JR., OF THE BUREAU OF MINES, DATED SEPTEMBER 1944, PERTAINING TO TITANIUM PROPERTIES

* * * The report indicates that there were 27 holes in depths varying from 15 to 150 feet. The core samples averaged from 3 to 4 percent TiO_2. This exploration covered about 10 percent of the area of the company's property. Although the exploration depth did not exceed 150 feet the author of the above-mentioned report stated therein that the "geological inference" is that the ore deposit may be presumed to reach over 1,000 feet in depth. Local estimates based on the author's statement and expanded for the total area of the deposits existing on the company's property would indicate about 600,000 tons of rutile to a depth of 200 feet, or 3,000,000 tons if practical and economical to mine the area to a total depth of 1,000 feet.

* * * * * * *

Dr. R. G. Knickerbocker, Chief of Minerals Technology Division, region VI, Bureau of Mines, Rolla, Mo., personally told me over long-distance telephone on two occasions and in person at the Albert Pike Hotel recently that if he owned the property it would not be for sale, that he knows there is a tremendous deposit of titanium and that sooner or later a process will be found which will refine the ore into a finished metal that is so sorely needed by the Army, Navy, and Air Forces in the manufacture of war material.

* * * * * * *

Mr. Chapin, civilian chemist of Naval Research Laboratories in Washington, D. C., personally told me some 6 weeks ago while I was in Washington that he had been working on titanium for a period of 7 years trying to find a process to refine it into finished metal. He is sanguine about the possibilities of such process being developed.

[Preprint from Bureau of Mines Minerals Yearbook, 1949]

TITANIUM

(By Helena M. Meyer)

GENERAL SUMMARY

The year 1949, like 1948, was characterized by widespread interest and research in connection with the production of titanium metal and alloys. The unprecedented amount of money and effort being expended by Government and industry in experimental work are largely responsible for the many predictions that titanium will find large-scale use much more rapidly than its predecessor metals. More than one authority predicted during the year that titanium and titanium alloys would become primary structural materials within 10 years. The problem of producing metal at a price low enough to attract production and consumption in large quantities remains to be solved. In 1949 titanium metal was produced commercially for the second successive year and on an increasing scale. One pilot plant operated continuously at approximately 100 pounds a day throughout the year, and a second pilot plant of somewhat larger capacity went into production near the close of the year. Other pilot plants were under construction at the year end, and the Bureau of Mines continued production of metal at Boulder City, Nev., throughout the year.

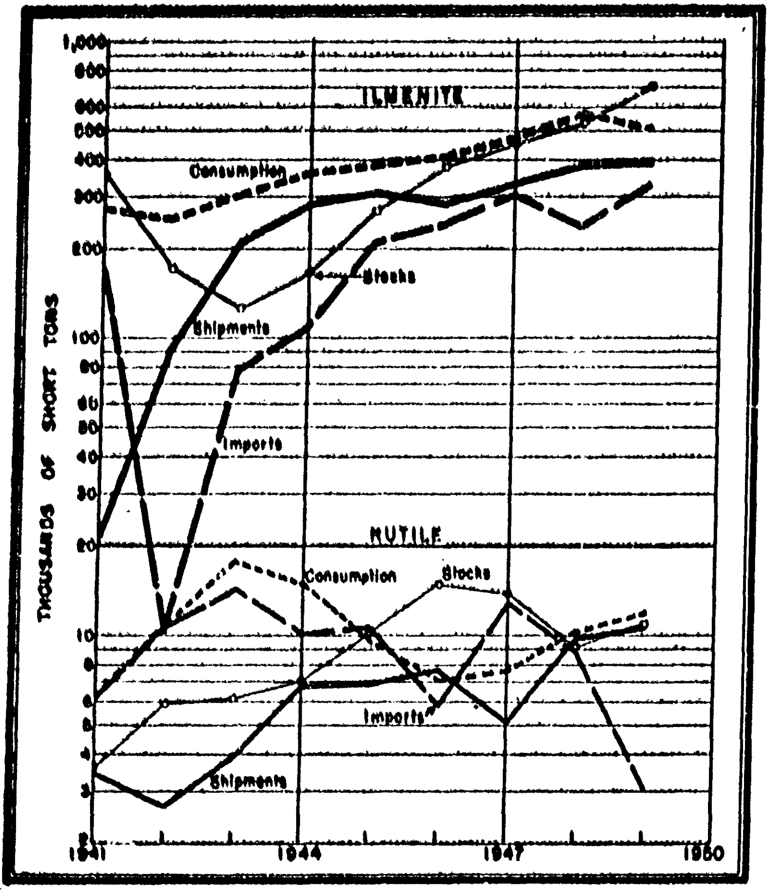
The titanium industry, in addition to the enthusiasm and energy expended in connection with the metal, was featured by new maximum production and shipments of ilmenite for the third successive year, by new peak imports, and by unprecedented output and shipments of rutile. However, 1949 was the first year in 7 that a new high ilmenite consumption record was not established. Rising inventories of crude materials were recorded also.

Present world sources of ilmenite and expected additions in the next year or two promise more than adequate supplies for present pigment needs, the only large tonnage use. Possibilities for expansion in requirements for the production of metal, however, as well as for potential growth in consumption in pigments, as a result of hoped-for improvement in world living standards particularly outside of the United States, are such that it is not safe to forecast that anticipated world supplies for the next several years will greatly exceed world requirements.

Production and shipments of ilmenite were 5 and 2 percent, respectively, greater than in 1948, following 14-percent gains for both in that year. Imports were 84 percent higher than in 1948 and 8 percent above the earlier peak in 1947. Domestic shipments and imports together were 40 percent above consumption, resulting in a 83-percent rise in industry stocks. Inventories at the end of 1949 were equivalent to 1.4 years' needs at the 1949 rate of use.

Titanium pigments, which take 99 percent of the ilmenite consumed in the United States, declined 6 percent in output and 9 percent in shipments in 1949. The drop in general industrial activity in midyear adversely affected use of titanium pigments; but this class of pigments fared much better than other white pigments, namely white lead (dry and in oil), zinc oxide (lead-free and leaded), and lithopone, shipments of which declined 41, 33, and 44 percent, respectively, in 1949 as compared with 1948.

Production and shipments of rutile were 62 and 7 percent, respectively, larger than in 1948 and thus established new peaks. Some of the material covered, however, was not consumed for customary rutile purposes (see section on Domestic Production). Imports of rutile were little more than one-third of the reduced quantity entered in 1948. Supplies from domestic and foreign sources were more than adequate for the increased requirements in 1949, and inventories rose 18 percent. Stocks at the year end would fill United States needs at the 1949 rate of consumption for 11 months.



Quotations for both ilmenite and rutile trended downward in 1949, a reflection of the ample supply of these concentrates in that year. The average quotation per gross ton for ilmenite containing 56-59 percent TiO_2, f. o. b. Atlantic seaboard, dropped from a range of \$18-\$20, according to grade and impurities, at the beginning of the year to \$14-\$16 in the first half of November and continued at this level beyond the year end. Quotations were nominal throughout the year. Nominal quotations for rutile, guaranteed minimum 94 percent concentrate, after continuing at 8-10 cents a pound for a number of years, fell to 6-8 cents in December 1948 and further to 4-5 cents by the end of 1949.

Progress toward bringing into production an ilmenite property that will rank with the world's largest producers and may exceed all others was reported in 1949. This is the property of the Quebec Iron & Titanium Corp. (owned by the Kennecott Copper Corp. and the New Jersey Zinc Co.) in the Allard Lake area of Quebec, Canada.

DOMESTIC PRODUCTION

Production and shipments of ilmenite rose 5 and 2 percent, respectively, in 1949, and both established new records for the third successive year. Rutile likewise reached new peaks in both classes, but rutile in 1949 includes a quantity of mixed product containing altered ilmenite, leucoxene, and rutile. The mixed product more nearly resembles rutile than ilmenite in TiO_2 content but was used in the manufacture of titanium pigments and metal. Total shipments of ilmenite ranged from 44 to 64 percent TiO_2 and of rutile from 84 to 96 percent TiO_2.

Arkansas.—Several recent reports[1] of the Bureau of Mines referred to titanium in Arkansas.

Production and mine shipments of titanium concentrates from domestic ores in the United States, 1940–44 (average) and 1945–49, in short tons

Year	Ilmenite				Rutile			
	Production	Shipments			Production	Shipments		
		Gross weight	TiO_2 content	Value		Gross weight	TiO_2 content	Value
1940–44 (average)	120,007	120,030	60,028	$[illegible]	3,918	3,860	3,617	$169,394
1945	308,510	308,518	141,832	7,369,170	7,170	6,847	6,414	809,920
1946	292,447	292,708	130,021	4,878,917	7,181	7,614	7,016	905,989
1947	330,643	310,001	157,828	5,020,490	8,062	5,167	4,813	633,648
1948	383,716	381,708	177,417	6,793,073	7,390	9,907	9,225	617,334
1949	402,834	389,214	180,636	6,212,318	[1] 11,988	[1] 10,650	[1] 9,414	489,798

[1] Includes a mixed product containing altered ilmenite, leucoxene, and rutile.

California.—A small quantity of ilmenite was produced at the property of the Ferro-Titan Minerals Co., Sun Valley, Los Angeles County, Calif.

Florida.—The property of E. I. du Pont de Nemours & Co. at Starke, Fla., began to produce ilmenite and a mixed product containing altered ilmenite, leucoxene, and rutile in March 1949. The mixed product is included in this report in the rutile tonnages because it more nearly resembles rutile in TiO_2 content, although it was used in 1949 to make pigments and metal. In addition of this product to rutile resulted in raising United States production and shipments to the highest annual quantities on record. A report[2] on titanium in Florida was recently released. According to this report, the du Pont property was expected to produce 100,000 tons of titanium products annually. As a result of the disclosure of a large concentration of heavy minerals in Trail Ridge, owing to drilling by the Bureau of Mines and extensive investigation by du Pont, as well as indication of the possibility of similar occurrences elsewhere, the drilling of other locations within the State was begun in August 1947. This exploration was completed in April 1948, and results were described in the aforementioned report.

Production of ilmenite and rutile came again from the Rutile Mining Co. of Florida near Jacksonville and from the property of the Florida Ore Processing Co. near Melbourne.

New York.—Production of ilmenite at Tahawus, Essex County, N. Y., by the National Lead Co. in 1949 slightly exceeded that in 1948 and thus established a new peak by a narow margin. This property continued to be the leading producer in the world. A brochure prepared by the company, dated August 29, 1949, for distribution to an inspection party of the United Nations Conference on Conservation and Utilization of Resources, contained the following paragraph on production:

Since beginning operation in 1942, 7,000,000 tons of ilmenite-magnetite ore have been mined from the MacIntyre open-cut. To accomplish this 5,000,000 tons of rock and soil were removed from this immediate area to make this ore available for open-cut mining. From this ore 1,000,000 tons of ilmenite and 3,000,000 tons of magnetite concentrates were produced. All of the ilmenite was shipped directly to processing plants, while 1,000,000 tons of the magnetite (iron ore) have been converted to sinter and 500,000 tons have been shipped as raw concentrate to various iron, steel, and other manufacturers. At present, 1,500,000 tons of magnetite remain in stockpiles at the plant and are currently being shipped to steel companies.

Technical progress is disclosing new uses for titanium and its derivatives, one of the most recent being the use of the metal itself in uses which combine the

[1] Reed, Donald F., Investigation of Christy Titanium Deposit, Hot Spring County, Ark.: Bureau of Mines Rept. of Investigations 4592, 1949, 10 pp. Investigation of Magnet Cove Rutile Deposit, Hot Springs County, Ark.: Bureau of Mines Rept. of Investigations 4593, 1950, 9 pp.

Calhoun, W. A., Titanium and Iron Minerals from Black Sands in Bauxite: Bureau of Mines Rept. of Investigations 4621, 1950, 16 pp.

[2] Thoenen, J. R., and Warne, J. D., Titanium Minerals in Central and Northeastern Florida: Bureau of Mines Rept. of Investigations 4515, 1949, 62 pp.

properties of stainless steel and aluminum. This promises increased demand for titanium ores, and continued operation of the MacIntyre Development for many years to come, with all the attendant benefits to its employees, the community in general, other supplier industries, the people of the State of New York, and the Nation.

North Carolina.—The Yadkin Mica & Ilmenite Co., subsidiary of the Glidden Co., produced 31,864 tons of ilmenite (averaging 51 percent TiO_2) at Finley, Caldwell County, N. C., and shipped 31,714 tons. The 1949 output and shipments were 8 and 10 percent, respectively, above 1948. Production in 1949 was at a new record rate, marked a continuous rise since 1946, and was 80 percent above that year.

Virginia.—Ilmenite and rutile were produced again in 1949 near Roseland, Nelson County, Va., by the American Rutile Corp., subsidiary of the Metal & Thermit Corp. This property closed in July; the corporation was in process of liquidation early in 1950 owing to the fact that the grade of ore mined at Roseland is too low to be profitable. The Calco Chemical Division of American Cyanamid Co. continued to produce ilmenite at Piney River, also in Nelson County.

CONSUMPTION AND USES

Consumption of ilmenite dropped 10 percent in 1949 and thus failed to establish a new peak for the first time in 7 years; except for 1948, the rate of use in 1949 was at a higher level than ever before. The manufacture of pigments, as usual, took 99 percent of all ilmenite consumed. In addition a high percentage of the rutile used was consumed in the manufacture of pigments. Actually the material so used was a mixed product containing altered ilmenite, leucoxene, and rutile, which in titanium dioxide content resembled rutile more closely than ilmenite. The total tonnage shown as rutile was 16 percent above 1948, but the quantity for customary rutile uses dropped in 1949.

Consumption of ilmenite and rutile in the United States, 1941–46 (total) and 1947–49, by products, in short tons

Product	Ilmenite		Rutile	
	Gross weight	Estimated TiO_2 content	Gross weight	Estimated TiO_2 content
1941	275, 106	150, 966	6, 361	5, 986
1942	257, 535	141, 412	10, 616	9, 952
1943	302, 822	142, 868	17, 634	16, 451
1944	360, 941	175, 475	14, 813	13, 837
1945	381, 178	187, 580	9, 791	9, 144
1946	404, 283	202, 663	7, 134	6, 670
1947				
Pigments (manufactured titanium dioxide) [1]	473, 154	248, 231		
Welding-rod coatings [1]	144	74	6, 425	5, 907
Alloys and carbide	5, 972	2, 431	1, 131	1, 050
Ceramics			102	95
Miscellaneous	254	123	34	31
Total consumption	479, 524	250, 859	7, 692	7, 083
1948				
Pigments (manufactured titanium dioxide) [1]	558, 448	297, 728	(²)	(²)
Welding-rod coatings [1]	145	72	7, 885	7, 289
Alloys and carbide	6, 377	2, 591	952	889
Ceramics			175	166
Miscellaneous	30	17	[3] 1, 218	[3] 1, 144
Total consumption	565, 000	300, 408	[4] 10, 230	[4] 9, 488
1949				
Pigments (manufactured titanium dioxide) [1]	505, 432	265, 854	(²)	(²)
Welding-rod coatings [1]	[illegible]	85	6, 399	5, 904
Alloys and carbide	4, 96[illegible]	2, 037	660	619
Ceramics	[illegible]		143	136
Miscellaneous	42	24	[5] [illegible], 686	[5] 4, 204
Total consumption	510, 608	[illegible], 000	[5] 11, [illegible]88	[5] 10, 863

[1] "Pigments" include all manufactured titanium dioxide, consumption of which in welding-rod coatings was 1,257 tons in 1947, 1,[illegible] tons in 1948 and 1,062 tons in 1949.
[2] Bureau of Mines not at liberty to publish; figures included in "Miscellaneous."
[3] Revised figures. Includes rutile used to make pigments.
[4] Revised figures.
[5] Includes a mixed product containing altered ilmenite, leucoxene, and rutile, used to make pigments and metal.

Titanium pigments.—Production and shipments of titanium pigments in 1949 dropped somewhat from 1949, following the establishment of five successive peaks; except for 1948, both items were at the highest annual rates ever attained. Figures on this industry are supplied in confidence and, consequently, are not given here. As already stated, a mixed product containing altered ilmenite, leucoxene, and rutile, produced at a domestic mine was used in 1949 chiefly in the manufacture of pigments.

Distribution of titanium pigments shipments, by industries, 1935–49, in percent of total

Year	Paints, varnishes, and lacquers		Floor, coverings (linoleum and felt base)		Coated fabrics and textiles (oilcloth, shade cloth, artificial leather, etc.)		Rubber		Paper		Printing ink		Other		Total	
	Gross weight	TiO_2 content	Gross weight	TiO_2 content	Gross weight	TiO_2 content	Gross weight	TiO_2 content	Gross weight	TiO_2 content	Gross weight	TiO_2 content	Gross weight	TiO_2 content	Gross weight	TiO_2 content
1935	73.7	64.8	2.0	3.5	3.7	4.8	4.6	4.2	6.8	9.4	1.2	2.0	8.0	11.3	100.0	100.0
1936	77.4	66.7	2.1	3.8	4.9	6.2	3.2	3.6	7.0	10.6	1.2	2.1	4.2	7.0	100.0	100.0
1937	79.4	69.1	2.0	3.7	4.1	4.9	3.3	3.9	6.4	9.8	1.1	1.8	3.7	6.8	100.0	100.0
1938	76.8	65.9	2.6	4.7	3.5	4.8	3.7	4.2	8.9	13.1	1.2	2.0	3.3	5.3	100.0	100.0
1939	76.9	66.5	3.3	5.3	3.4	4.1	3.6	4.3	7.7	11.1	1.1	1.9	4.0	6.8	100.0	100.0
1940	76.4	66.7	3.6	5.3	2.7	3.3	3.0	3.7	6.9	10.4	1.0	1.7	6.4	8.9	100.0	100.0
1941	78.0	70.8	3.1	4.4	2.8	3.3	2.8	3.5	6.2	9.2	1.0	1.7	6.1	7.1	100.0	100.0
1942	79.1	71.3	2.6	3.6	2.7	3.5	.8	1.0	5.3	7.6	.8	1.4	8.7	11.6	100.0	100.0
1943	78.0	69.5	2.4	3.1	1.9	2.6	.8	1.1	6.7	9.5	1.0	1.7	9.2	12.5	100.0	100.0
1944	79.1	71.9	2.0	2.7	1.9	2.4	.7	1.0	6.4	8.6	.8	1.4	9.1	12.0	100.0	100.0
1945	79.7	73.4	2.0	2.5	1.5	2.0	1.1	1.6	6.7	9.3	.9	1.4	8.1	9.8	100.0	100.0
1946	78.6	71.9	2.5	3.1	1.8	2.3	2.0	2.8	6.1	8.6	.9	1.5	8.1	9.8	100.0	100.0
1947	81.5	74.3	3.7	4.7	2.1	2.6	2.6	3.4	5.5	7.8	.9	1.5	3.7	5.7	100.0	100.0
1948	76.4	69.9	4.5	5.9	2.1	2.7	2.5	3.2	5.4	7.4	.9	1.4	8.2	9.5	100.0	100.0
1949	74.5	67.5	4.6	5.8	1.6	2.1	3.1	3.9	6.6	9.6	.9	1.4	8.7	9.7	100.0	100.0

Metal.—Titanium metal was produced on a commercial basis at Newport, Del., by E. I. du Pont de Nemours & Co. for the second successive year. One pilot plant was operated continuously at approximately 100 pounds a day throughout the year and a second pilot plant of somewhat larger capacity went into production near the close of the year. Bureau of Mines produced metal at the rate of 200 pounds a week, except for several brief interruptions. Early in the year most of the output was in the form of powder, but at the end of the year production was largely in the form of sponge. A pilot plant for metal production was under construction at Sayreville, N. J., by the National Lead Co. at the end of 1949 and began to produce early in 1950. The potential uses of titanium metal were recently discussed.[3] The authors indicated that although this relatively new metal with unique and highly desirable properties has a promising future, its production today is too costly to warrant the conclusion that it will have almost universal applications and compete with steel, aluminum, and copper where these cheaper metals can function satisfactorily.

Welding-rod coatings.—Production of titanium-coated welding rods was 154,000 short tons in 1949, a drop of 18 percent from the 188,000 tons for 1948; 153,000 tons were coated in 1947, 133,000 in 1946, and 481,000 in 1943. Of the 1949 tonnage, 54 percent was coated with natural rutile, 33 percent with manufactured titanium dioxide, and nearly 7 percent each with both varieties and with ilmenite.

Other uses.—In a recent article[4] it was pointed out that alkyl titanates, derived from the action of titanium tetrachloride on alcohols, are very effective waterproofing agents. These compounds, the titanium analogs of alkyl silicates, are capable of imparting a water-repellent finish to such diverse materials as paper, cotton, wool, rayon, nylon, silk, felt, and wood.

An article[5] stated that, although the superior qualities of titanium dioxide as an opacifier have been known for many years, its commercial utilization as the major opacifying agent in porcelain enamels is a comparatively recent de-

[3] Ralston, Oliver, and Cservenyak, F. J., Potential Uses of Titanium Metal: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 214–218.

[4] Speer, Robt. J., and Carmody, D. R., Organic Compounds of Titanium: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 251–253.

[5] Spencer-Strong, G. H., and Patrick, Robt. F., Titanium in Porcelain Enamels: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 253–256.

velopment. The development and physical properties of these enamels were discussed. The fact that the enamels are applied directly to the metal without the need of an intermediate ground coat was said to be an outstanding development. Another article[6] discussed the standards and practices that permit application of titanium enamel to steel without the use of a ground coat. A development of increasing scientific and technical importance, another article[7] stated, was the electromechanical effect exhibited by barium titanate ceramics under the influence of a high electric polarizing field. Titanate ceramics, the author said, have become an important raw material for the manufacture of capacitors, especially in certain types of high-voltage condensers, such as those used in television sets.

Titanium carbides were discussed in articles[8] appearing recently.

Experiments were conducted on the preparation of metal-ceramic seals by use of brazing alloy and a flux of titanium hydride in an atmosphere of highly purified hydrogen.[9]

Efforts to form single crystals of rutile were described[10] in recent literature. Synthetic rutile for use as gem stones is an outgrowth of such investigations.

STOCKS

Inventories of ilmenite rose 33 percent in 1949 and were equivalent to 15 months' requirements at the record rate of consumption maintained in 1948; they were adequate for 15 months at the 1949 rate. Rutile stocks rose 18 percent in 1949 and would sustain industry at the 1949 rate of use for 11 months.

Stocks of titanium concentrates in the United States at end of year, 1948–49, in short tons

Stocks	1948				1949			
	Ilmenite		Rutile		Ilmenite		Rutile	
	Gross weight	Estimated TiO_2 content	Gross weight	Estimated TiO_2 content	Gross weight	Estimated TiO_2 content	Gross weight	Estimated TiO_2 content
Mine	3,983	1,800	1,500	1,399	16,933	7,569	2,952	2,750
Distributors[1]	4,499	1,809	4,218	3,986	2,478	1,026	4,329	4,090
Consumers	522,077	250,559	3,493	3,255	683,635	332,156	3,586	3,148
Total stocks	530,559	254,168	9,211	8,640	703,046	340,751	10,867	9,988

[1] Includes ilmenite and rutile content of mixed zirconium-titanium concentrates.

PRICES

The average E&MJ Metal and Mineral Markets quotation per gross ton for ilmenite containing 56–59 percent TiO_2, f. o. b. Atlantic seaboard, dropped from a range of $18–$20, according to grade and impurities, at the beginning of the year to $16–$18 in early October, to $15–$17 late in that month, and further to $14–$16 in the first half of November. There were no further changes in 1949. Quotations were given as nominal. Nominal quotations for rutile, guaranteed minimum 94-percent concentrate, after continuing at 8–10 cents a pound for a number of years, fell to 6–8 cents in December 1948, to 4–6 cents in May 1949, and further to 4–5 cents by the end of the year.

[6] Swartz, John C., Titanium Enamel to Titanium Steel: Steel, vol. 124, No. 3, Jan. 17, 1949, pp. 64–65 and 96.

[7] Jaffe, Hans, Titanate Ceramics for Electromechanical Purposes: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 264–268.

[8] Redmond, Joyn C., Cemented Titanium Carbide: Jour. Metals, vol. 1, No. 12, December 1949, pp. 987–993.

Rose, Kenneth, Cemented Carbides: Materials & Methods, vol. No. 2, February 1949, pp. 74–84.

[9] Metal progress, Brazing Metals to Nonmetals: Vol. 57, No. 2, February 1950, pp. 261, 262 and 264.

[10] Moore, Chas. H., Jr., Formation and Properties of Single Rutile Crystals of Synthetic Rutile: Min. Eng., vol. 1, No. 6, June 1949, pp. 194–199.

According to the magazine Steel, quotations for ferrotitanium were unchanged throughout 1949, as follows:

Ferrotitanium, Low-Carbon: (Ti 20–25 percent, Al 3.5 percent maximum, Si 4 percent maximum, C 0.10 percent maximum). Contract, ton lots, 2" x D, \$1.40 per pound of contained Ti; less ton \$1.45. (Ti 38–43 percent, Al 8 percent maximum, Si 4 percent maximum, C 0.10 percent maximum). Ton lot \$1.28, less ton \$1.35, f. o. b. Niagara Falls, N. Y., freight allowed to St. Louis. Spot add 5 cents.

Ferrotitanium, High-Carbon: (Ti 15–18 percent, C 6–8 percent). Contract \$160 per net ton f. o. b. Niagara Falls, N. Y., freight allowed to destination east of Mississippi River and north of Baltimore and St. Louis.

Ferrotitanium, Medium-Carbon: (Ti 17–21 percent, C 3–4.5 percent). Contract, \$175 per ton f. o. b. Niagara Falls, N. Y., freight not exceeding St. Louis rate allowed.

Titanium metal, 96–98 percent, was quoted at \$5–\$6 a pound from mid-September 1948 through September 1949, after which it was quoted for the remainder of the year at \$5.

Manufactured titanium dioxide (anatase), chalk-resistant, plain, and (rutile) nonchalking, in bags, carlots, delivered, were quoted in Oil, Paint and Drug Reporter throughout the year at 19½, 19½, and 21½ cents a pound, respectively. Beginning October 31, quotations on a ceramic grade were added; this grade was quoted at 19½ cents a pound from then to the end of the year.

FOREIGN TRADE [11]

From a tonnage standpoint, foreign trade in titanium materials is preponderantly of imports of the crude products, ilmenite and rutile. Exports are largely of titanium dioxide; the values of exports of this class and of ferrotitanium far exceed the combined values of receipts of ilmenite and rutile from abroad.

Imports.—Receipts of ilmenite established a new record in 1949, being 34 percent higher than in 1948 and 8 percent above the previous peak in 1947. Imports from India, always by far the dominant source, were likewise at a new top, having exceeded slightly the previous high in 1939. Imports from Norway, which had been rising, dropped 20 percent in 1949. Norway supplied 10 percent of the 1949 total and was the only source of consequence outside of India. Brazil and Malaya, which sent significant quantities to the United States in 1948, did not appear on import declarations in 1949. Only 38 short tons of ferrotitanium were entered in 1949, all from the United Kingdom.

All imports of rutile again were from Australia; little more than one-third of the 1948 quantity was received in 1949.

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[11] Figures on imports and exports compiled by M. B. Price and E. D. Page, of the Bureau of Mines, from records of the U. S. Department of Commerce.

Titanium concentrates[1] *imported for consumption in the United States, 1940–44 (average) and 1945–49, by countries, in short tons*

[U. S. Department of Commerce]

Country of origin	1940–44 (average)	1945	1946	1947	1948	1949
ILMENITE						
Australia [2]	214	1,753	....	[3] 1,659	(4)	....
Brazil	2,102	10,508	2	1	8,708	....
Canada	21,050	6,987	1,250	7,122	4,519	540
Ceylon	930	....	....	....	....	2
Egypt	....	....	....	....	....	721
India	89,981	179,693	218,623	262,503	184,309	289,739
Malaya	....	....	....	....	3,335	....
Norway	....	9,895	21,077	30,026	41,248	33,165
Portugal	194	....	....	....	....	....
Total as reported	116,077	208,836	240,952	301,311	242,119	324,167
Australia: In "zirconium ore" [2]	3,329	[5] 1,236	1,388	....	....	....
Grand total	118,406	210,072	242,340	301,311	242,119	324,167
Value of "as reported"	$483,443	$1,217,339	$1,440,112	$1,791,020	[6] $1,758,848	$2,479,071
RUTILE						
Australia [2]	1,340	3,070	4,377	7,460	8,771	3,085
Brazil	2,826	234	31	....	....	....
French Cameroon [7]	248	....	....	3	....	....
India	190	....	....	113	....	....
Norway	....	....	....	....	(4)	....
Portugal	1	....	....	....	....	....
Total as reported	4,605	3,304	4,408	7,576	8,771	3,085
Australia:						
In "zirconium ore" [2]	4,062	7,298	1,456	....	....	....
In "ilmenite"	....	....	....	[3] 5,061	....	....
Grand total	8,667	10,602	5,864	12,637	8,771	3,085
Value of "as reported"	$408,170	$98,170	$213,795	$468,810	$588,713	$179,746

[1] Classified as "ore" by the U. S. Department of Commerce.

[2] Most of the imports of titanium from Australia in 1940-47 were in mixed zircon-rutile ilmenite concentrates. Totals of mixed concentrates are derived by addition of the U. S. Department of Commerce figures for imports of ilmenite, rutile, and "zirconium ore" from Australia. These totals are apportioned by the Bureau of Mines (on the basis of surveys of importers) into the 3 component minerals. The excess quantities of ilmenite and rutile over the quantities reported by the U. S. Department of Commerce in those specific categories are entered as "In 'zirconium ore'."

[3] Most of the ilmenite, rutile, and zircon from Australia in 1947 was imported in the form of zircon-rutile or zircon-rutile-ilmenite mixed concentrates. These concentrates (including separated concentrates of a single mineral) totaled 36,074 short tons, of which 1,659 were ilmenite, 12,521 rutile, and 21,894 zircon. For statistical convenience, it can be assumed that 5,061 tons of the material reported by the Department of Commerce as ilmenite was actually rutile; the value of this 5,061 tons of rutile, however, is inseparable from the ilmenite as reported.

[4] Less than 1 ton.

[5] Includes 309 tons not recovered from mixed concentrates.

[6] Revised figure.

[7] Includes quantities reported by the U. S. Department of Commerce as originating in French Equatorial Africa, from which no rutile production has been recorded.

Exports.—Shipments of titanium materials from the United States consist largely of titanium pigments. The uptrend in exports of this item, in virtually continuous progress since the movement began prior to 1939, reached a new high level in 1949. Exports totaled 20,621 tons in 1949 or considerably more than double the quantity for 1945. Canada was by far the chief destination of titanium dioxide exports with 10,053 tons, and next in importance were Brazil with 1,577 tons, France 1,409, Belgium-Luxembourg, 1,150, Mexico 959, Cuba 859, Netherlands 770, followed by 49 other countries with smaller quantities. Exports of concentrates totaled 1,505 tons, of which Canada received 904, Netherlands 386, Belgium-Luxembourg 132, and four other countries the remainder. Canada received 127 tons of the ferro-alloys exported and Belgium-Luxembourg 28; insignificant quantities went to six others.

Exports of titanium products from the United States, 1942–44 (average) and 1945–49, by classes

[U. S. Department of Commerce]

Year	Concentrates		Ferro-alloys		Dioxide and pigments		Tetrachloride and other compounds	
	Short tons	Value	Short tons	Value	Short tons	Value	Short tons	Value
1942–44 (average)	495	$91,220	[1] 658	[1] $101,828	9,853	$1,796,411	376	$223,984
1945	609	121,951	744	122,887	12,824	2,315,552	75	46,718
1946	1,385	200,866	550	63,723	16,314	3,092,607	(2)	(2)
1947	1,266	192,703	509	80,590	21,171	5,183,936	(2)	(2)
1948	1,454	187,225	480	82,874	26,824	7,126,956	(2)	(2)
1949	1,505	143,412	179	40,918	29,621	8,140,991	(2)	(2)

[1] Includes metal and nonferrous alloys.
[2] Beginning Jan. 1, 1946, not separately classified.

TECHNOLOGY

Treatment of titaniferous ores was the subject of reports published [12] recently.

Progress in research work on the development of a new method for preparing lower-cost titanium tetrachloride and preparing titanium oxide pigment was reported [13] in 1949.

Bureau of Mines production of metallic titanium was described.[14] The report states that—

"To produce ductile titanium by powder metallurgy, the method used by the Bureau, it is necessary to start with powder free from gaseous impurities. Although hydrogen, if present, can be removed completely enough for all practical purposes by heating the metal in a high vacuum, no method of removing nitrogen or oxygen is yet known. To prevent contamination, therefore, the titanium tetrachloride from which the powder is produced is treated in equipment so designed that the titanium comes in contact only with iron and helium during production. After it has cooled to room temperature, exposure of titanium to air does no material harm."

The history of titanium tetraiodide was recently reviewed [15] and a new method of its preparation described. The authorities stated:

"The practical importance of titanium tetraiodide increased greatly when van Arkel and de Boer showed that it could be thermally decomposed by impingement of the vapors on a highly heated tungsten wire, with the building up of a rod of pure titanium metal and the liberation of elementary iodine. To date, the best ductile titanium metal has been produced by the van Arkel-de Boer method."

Several recent articles [16] bore on the properties of titanium metal and also on the effects of other elements thereon. A résumé of current findings in connection

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[12] Armant, D. L., and Cole, S. S., Laboratory Smelting of Titaniferous Ores: Jour. Metals, vol. 1, No. 12, December 1949, pp. 909–918.
MacMillan, Robert. T., Dinnin, Jos. I., and Conley, John E., Proposed Process for Treatment of Low-Grade Titaniferous Ores: Bureau of Mines Rept. of Investigations 4638, 1950, 19 pp.

[13] Knickerbocker, R. G., Gorski, C. H., Kenworthy, H., and Starliper, A. G., Titanium Investigations: Research and Development Work on the Preparation of Titanium Chloride and Oxide from Titanium Mattes: Jour. Metals, vol. 1, No. 11, November 1949, pp. 785–791.

[14] Wartman, F. S., Walker, J. P., Fuller, H. C., Cook, M. A., and Anderson, E. L., Production of Ductile Titanium at Boulder City, Nev.: Bureau of Mines Rept. of Investigations 4519, 1949, 37 pp.

[15] Blumenthal, Warren B., and Smith, Howard, Titanium Tetraiodide: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 249–251.

[16] Gee, E. A., and Golden, L. B., Titanium and Zironium Corrosion Studies: Ind. Eng. Chem., vol. 41, No. 8, August 1949, pp. 1668–1673.
Jaffee, Robt. I., and Campbell, I. E., The Effect of Oxygen, Nitrogen, and Hydrogen on Iodide-Refined Titanium: Jour. Metals, vol. 1, No. 9, September 1949, pp. 646–654.
Fuller, F. B., Some New Data on the Properties of Wrought Titanium: Metal Progress, vol. 56, No. 3, September 1949, pp. 348–350.
Gee, E. A., Sutton, J. B., and Barth, W. J., Effect of Carbon in Titanium Metal Ingots: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 243–249.

with titanium and titanium alloys was recently made available.[17] Many other articles on titanium alloys also were released, of which some are listed.[18]

WORLD REVIEW

Available data on world production of ilmenite and rutile in recent years are shown in the accompanying table.

World production of titanium concentrates (ilmenite and rutile), by countries, in metric tons, 1943–49

[Compiled by Pauline Roberts]

Country	1943	1944	1945	1946	1947	1948	1949
ILMENITE							
Australia:							
New South Wales	3,815	3,590	2,485	1,636	[1] 3,551	[1] 7,489	[1,2] 4,599
Queensland	1,655	3,697	4,186	4,258	[1] 2,934	[1] 4,318	[1,2] 2,752
Tasmania	....	....	....	....	844	....	....
Brazil (exports)	....	3,250	5,000	....	....	7,900	(3)
Canada	62,992	30,820	12,834	1,275	6,445	4,029	....
Egypt	....	9	46	146	....	1,034	(3)
India	38,396	102,412	174,848	187,993	257,476	233,098	(3)
Malaya	....	....	....	....	[4] 13,291	12,909	20,034
Norway	66,191	63,975	28,312	52,574	69,711	93,322	(3)
Portugal	121	....	301	633	243	155	680
Senegal [5]	730	....	3,200	4,191	11,282	3,600	8,338
Spain	178	548	216	128	150	181	311
United States	184,657	252,749	279,880	256,230	305,296	348,126	364,989
Total ilmenite	358,735	461,050	511,308	509,064	671,223	716,251	(3)
RUTILE							
Australia:							
New South Wales	4,828	4,597	5,292	4,876	9,068	[1] 7,110	[1,2] 5,591
Queensland	1,902	4,246	4,609	3,407	4,338	[1] 6,411	[1,2] 3,358
Brazil (exports)	4,557	1,564	160	28	5	....	(3)
French Cameroon	2,735	3,320	1,440	1,260	755	(3)	403
India	2,396	1,672	620	262	159	129	(3)
Norway	116	85	76	63	51	....	(3)
United States	3,617	6,279	6,513	6,761	7,767	6,695	10,875
Total rutile	20,151	21,763	18,710	16,657	22,143	21,000	20,400

[1] Excludes content of beach sand in stock dumps.
[2] January to September, inclusive.
[3] Data not available.
[4] Exports.
[5] Approximately 20 percent of ilmenite concentrates is zircon.

Australia.—A plant for the production of titanium pigments was completed[19] by Australian Titan Products, Ltd., subsidiary of British Titan Products Co., Ltd., near Burnie, Tasmania, in 1949. Initial output of 5 tons daily (about 1,800 annually) was anticipated; this was expected to be increased by 1951 to 10 tons daily. Indian ilmenite was being used, but experiments with Australian concentrate were in progress. Titanium dioxide was produced[20] experimentally in 1949 from Australian rutile by Zircon Rutile, Ltd., at South Yarra, Victoria. Construction of a larger plant was under consideration. Australia has produced[21] experimental quantities of titanium metal. Research work has been carried out by the Australian Council for Scientific and Industrial Research. Technology of production of the metal in the form of rod, wire, and sheet has

[17] Steel, Titanium and Titanium Alloys: Vol. 124, Nos. 25 and 26, June 20 and June 27, 1949, pp. 101–104, 132, 135, and 58–61, 92, 94.

[18] Kuhn, W. E., Kinsey, H. V., and Ellis, O. W., A Study of Some Alloys of Titanium: Canad. Min. and Met. Bull., vol. 43, No. 454, February 1950, pp. 74–87.

Gonser, Bruce W., Titanium Alloys: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 222–226.

Brace, P. H., Hurford, W. J., and Gray, T. H., Preparation and Properties of Titanium-Base Alloys: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 227–236.

Larsen, E. I., Swazy, E. F., Busch, L. S., and Freyer, R. H., Fabrication of Titanium-Rich Alloys: Ind. Eng. Chem., vol. 42, No. 2, February 1950, pp. 237–242.

Aust, K. T., and Pidgeon, L. M., Solubility of Titanium in Liquid Magnesium: Jour. Metals, vol. 1, No. 9, September 1949, pp. 585–587.

[19] Queensland Government Mining Journal, Zircon-Rutile-Ilmenite: Vol. 50, No. 578, July 1949, pp. 875–876.

[20] Oil, Paint and Drug Reporter, Trade Briefs: Vol. 156, No. 4, July 25, 1949, p. 66.

[21] Metal Industry, Australia Titanium Supply: Vol. 75, No. 19, Nov. 4, 1949, p. 408.

been developed by the Physical Metallurgy Section of the council in collaboration with the University of Melbourne.

Canada.—Progress in 1949 was reported in development of the Allard Lake property by the Quebec Iron & Titanium Corp.—owned two-thirds by the Kennecott Copper Corp. and one-third by the New Jersey Zinc Co. At the end of the year the 27-mile railway from Harve St. Pierre to the mine was more than half completed, and construction of harbor facilities was well under way, according to Kennecott's annual report to stockholders. Construction of the wharf and smelter at Sorel, on the south bank of the St. Lawrence River, was in progress, as was construction of the power line from Three Rivers. If the present schedule is maintained in 1950, as anticipated, one furnace of the five now contemplated, should be in operation in 1951. The over-all expenditure to bring the property to the anticipated daily production of 1,500 tons of ilmenite, to yield 500 tons of iron and 700 tons of titanium dioxide, now is expected to be $30,000,000. The company's annual production target was 550,000 tons of ore, from which the furnaces at Sorel would yield 175,000 tons of high-grade iron and 250,000 tons of titanium oxide slag, averaging over 70 percent TiO_2.

Dominion Magnesium, Ltd., began production of titanium metal in September 1948 at its Government-built pilot plant at Haley, Ontario, using the Pidgeon-Rostrom process, claimed to be considerably cheaper than other processes. Ingots of 25 to 200 pounds of metal of 99.5–99.6 percent purity are being produced occasionally for Government experimental work.

Ceylon.—From time to time the reports of this series have indicated that consideration was being given to the production of ilmenite from extensive black beach sands in Ceylon. Several reports in 1949 indicated that the Government proposed erecting a milling plant; and one, at least, indicated [a] that a plant for the production of pigments was under consideration. Plans were for exploitation first of the sands at Pulmoddai in the Trincomalee district.

India.—Before World War II, India led all other countries by a substantial margin in the production of ilmenite. The disruption to international trade, caused by World War II, resulted in establishment of the United States as the leading world producer of this product. Concern has been expressed in India over the possible loss of the United States market as an outlet for Indian ilmenite exports, but the shipment of new peak quantities of these concentrates to the United States in 1949 showed that the fears were premature and perhaps entirely unwarranted.

United Kingdom.—Imports of titanium ores into the United Kingdom were reported as 75,693 long tons in 1949 compared with 57,247 in 1948 and 71,250 in 1947.

Senator BYRD. I understand Mr. Miles E. Robertson must take a plane, so we will hear from him now.

STATEMENT OF MILES E. ROBERTSON, PRESIDENT AND GENERAL MANAGER, ONEIDA, LTD., ONEIDA, N. Y.

Mr. ROBERTSON. Mr. Chairman and members of the Senate Finance Committee, my name is Miles E. Robertson. I am president and general manager of Oneida, Ltd., Oneida, N. Y., manufacturers of sterling silver and silver-plated flatware.

I appear before you in opposition to the proposal of the Secretary of the Treasury that the 20-percent retail excise tax on jewelry be extended to silver-plated flatware, for the reason that the knives, forks, and spoons, which constitute the category of silver-plated flatware, are not luxury items but are just as necessary in every home as cups and saucers, which bear no tax. It is to this proposal by Secretary Snyder that I now address myself.

We all realize that the defense program may last for a long time; the tax and fiscal program of the Federal Government, therefore, must be adjusted to an indefinite period of high defense expenditures.

[a] Mining Journal (London), Ceylon and India: Vol. 232, No. 5934, May 14, 1949, p. 351.

If inflation is to be kept within reasonable control, there must be some emergency taxation to meet the situation.

Excise taxes, usually on luxury or nonessential items, have been considered a valid section of such emergency taxation programs.

It is easily demonstrated that silver-plated knives, forks, and spoons are not luxury items. They are, on the contrary, essential items which should not carry an excise tax unless there is to be imposed an excise tax on the sales of all necessities. There is no justification for imposing a discriminatory excise tax on knives, forks, and spoons when other commonplace, utilitarian items are not subject to a similar tax.

It is my opinion that the proposal to place a 20-percent excise tax on knives, forks, and spoons stems from a series of misconceptions: First misconception: that, since silver is a precious metal, the use of the word "silver" in connection with any article implies that such article is a luxury item. Second misconception: that since one of the retail channels used in the distribution of silver-plated flatware is the jewelry store, any item carried and sold by the retail jeweler must automatically be a luxury and nonessential item. Combine these two misconceptions and you find the reason for the proposal of a 20-percent excise tax.

Let me now dispose of these misconceptions:

(*a*) The base metal of silver-plated flatware—knives, forks, and spoons—is nickel silver—copper, zinc, nickel alloy—and steel.

The silver plating is necessary both to give a pleasing appearance and to insure safety when spoons and forks are put in the mouth after acid foods. The amount of silver deposited, by all manufacturers in the industry, even on the better qualities, constitutes but a small fraction of the total weight of the piece.

The thickness of silver deposit varies from 0.000156 inch on the cheapest grade, to 0.00132 inch on the best grades. In both cases I have used a teaspoon for measuring, since that item is the most used piece in the home, and universally manufacturers plate it to a higher standard than is used on other pieces. Surely such plated articles are not luxury items, even though silver is used in the plating.

(*b*) Our merchandise is distributed in the United States through many different types of retail outlets, for example:

5-and 10-cent chain stores	15,000
Jewelry stores	15,000
Hardware stores	5,000
Miscellaneous variety stores	5,000
Department stores	2,500
Drug stores	1,000
Boarding house and restaurant supplies	600
Premium redemption stores	300

The mere fact that silver-plated flatware is sold in jewelry stores does not classify it as a luxury item or a nonessential item. If that be the logic, then the same reasoning would persuade us that the 5- and 10-cent stores and the hardware stores were mainly purveyors of luxury goods and nonessentials, because these two great groups of retailers also carry in stock, display, and sell large quantities of silver-plated knives, forks, and spoons.

Silver-plated knives, forks, and spoons are not "jewelry" within the general meaning of the term. This is the customary definition:

Jewelry includes articles designed to be worn on the person or apparel for the purpose of adornment and which, in accordance with custom of ordinary usage, are worn so as to be displayed, such as rings, chains, brooches, bracelets, cuff buttons, necklaces, earrings, beads, etc.

It also includes articles to be carried in the hand, or hung on the arm, or carried or worn on the person, whether in pocket or bag or under the outer garment, such as cigarette cases, eyeglass cases, pencils, powder boxes, garter buckles, canes, purses, or handbags, if made of, or ornamented, mounted, or fitted, with pearls, precious or semiprecious stones, or imitations thereof.

Knives, forks, and spoons are not jewelry. They are essential tools used in eating. In accepted society, at least, there are no substitutes for them. Remove them from the dining rooms and kitchens of America and you might just as well discard the chairs and the table, the tea kettle, and pots and pans. If such obviously utilitarian items are to be taxed, it must be because they are plated with silver. If they were not plated, they would be tax-free. But, actually, silver is not the governing factor. The question is, Are silver-plated knives, forks, and spoons essential to our civilian economy?

We, as manufacturers, understand the definition of luxury items and nonessential items:

(1) Sterling silver knives, forks, and spoons have been so classed, and now carry a 20-percent excise tax. We make sterling silver knives, forks, and spoons and have not complained about either the definition or the 20-percent excise tax. With the great body of our purchasing public, solid silver is a luxury. There are substitutes for sterling silver knives, forks, and spoons. Silver-plated knives, forks, and spoons are the substitutes for the lower-income families.

(2) Silver-plated hollowware—tea sets, vegetable dishes, trays, and so forth—have been classed as semiluxury items and now carry a 20-percent excise tax. We make silver-plated hollowware and have not complained about either the definition or the tax. There are substitutes for silver-plated hollowware. For the great bulk of our purchasing public, the china and glass industries offer reasonable substitutes.

On the question of "essentiality," silver-plated flatware must not be confused with sterling flatware or even silver-plated hollowware. Silver-plated knives, forks, and spoons are essential items in every home and there are no substitutes. Only in the Far East, where chopsticks are in common use, are substitutes to be found.

Silver-plated flatware—knives, forks, and spoons—has been repeatedly declared, by various Government agencies, as an essential civilian commodity.

During World War II the War Production Board clearly indicated that it considered silver-plated flatware as an essential civilian commodity. See War Production Board General Limitation Order L-140, issued November 5, 1943. Actually, during the war period, the Office of Civilian Requirements specifically arranged for the manufacture of tens of thousands of gross of silver-plated knives, forks, and spoons under its definition of a "necessity"—essential civilian commodity.

On February 3, 1949, our industry task group met with the National Security Resources Board in Washington. The Government officials, who conducted that meeting, stated that silver-plated flatware had been defined as an essential commodity.

Recently NPA limitation orders on copper, nickel, zinc, and so forth, have clearly defined silver-plated flatware as an essential civilian commodity.

In the tax laws of 1924, 1932, and 1943, the Congress specifically exempted silver-plated flatware—knives, forks, and spoons—from excise taxes on the proper ground that it was a "household necessity," as much so as china or glassware; but it was not a jewelry item and it was not a luxury.

There are over 12 million dozens of sliver-plated knives, forks, and spoons made and sold each year.

This quantity sorts up into approximately four different qualities, which are sold at four different price levels.

As a matter of statistics, not more than 20 percent of this volume is sold in jewelry stores; the other 80 percent is sold in hardware stores, drug stores, general stores, department stores, 5- and 10-cent stores, and so forth.

A very large percentage of the production is distributed in the hotel, restaurant, and boarding-house field. There, of course, it is just as important and just as much a necessity as are brooms, dustpans, glassware, and china.

Well over 1,500,000 dozens are distributed annually through the 5- and 10-cent stores.

This merchandise is resold at 15 cents, 20 cents, and 25 cents, depending on the size and type of the piece, and the margin of profit is very low. An excise tax would force higher prices, and since these chain stores usually adhere to 5-cent differentials in their pricing, the imposition of a tax would mean a more than ordinary increase in price.

The Government itself—National, State, institutions, and so forth—buys well over $1 million of these items each year. This is further indication that the items are necessities.

Generally speaking, the retailers in all trade categories cut down or soft pedal their advertising, merchandisin, and exploiting efforts on merchandise which carries a high excise tax, such as 20 percent. Their heaviest selling effort is reserved for tax-free merchandise.

Thus, excise taxes reduce sales or limit their increase, curtail employment, increase unit costs of production, increase the overhead burden, and reduce income-tax revenues which the Government would otherwise receive.

It is for these reasons solely that a manufacturer, such as Oneida, and so forth, would consider that a 20-percent excise tax on silver-plated knives, forks, and spoons was discriminatory. The items are essentials and household necessities and are properly classed with household furniture, chinaware, glassware, pots and pans, and so forth. If other essentials or semiessentials are tax-free, can it be equitable to single out knives, forks, and spoons for taxation?

Practical substitutes can be found in the case of all truly luxury items. There are no substitutes for knives, forks, and spoons.

For example, the GI's when they came home—thousands of whom were married before they left and other thousands who married later—found that they had to buy knives, forks, and spoons among their first purchases.

For those of limited income the 5- and 10-cent stores, hardware stores, and bargain basements are the natural suppliers. It does not seem proper for young men and young women, who are just starting to make a home, to find that their bare necessities are taxed the same as diamonds, fur coats, and sterling silver.

This noon you will eat your luncheon. You will buy food, but you will need certain essential equipment. Needed will be a table, a chair, a tablecloth and napkin, a glass, china, and knives, forks, and spoons.

Every one of these items is essential. Of them all, why should the knife, fork, and spoon be singled out to be taxed? Most of us eat three meals a day for 365 days in each year, and for as many years as we will live. We must have knives, forks, and spoons, until some genius can find substitutes other than sandwiches in a paper bag. Is that not a proper measure for "essentiality"?

There is now a 20 percent excise tax on jewelry, fur coats, sterling silver, and other luxury or semiluxury items.

Can it be other than unjust and discriminatory to impose the same 20 percent excise tax, and include in the same classification of "nonessentiality" an essential item such as silver-plated flatware?

In view of the reasons presented, I definitely beg and recommend that no excise tax be imposed on silver-plated flatware—knives, forks, and spoons.

Senator MILLIKIN (presiding). Thank you very much.

Our next witness this morning is Mr. Doub, Franklin Novelty Co., of Baltimore.

STATEMENT OF R. M. DOUB, FRANKLIN NOVELTY CO., BALTIMORE, MD.

Mr. DOUB. Mr. Chairman and committee members, I have a statement here which I would like to read.

Senator MILLIKIN. Make yourself comfortable.

Mr. DOUB. My name is R. M. Doub. My address is 644 West Baltimore Street, Baltimore, Md.

I am one of a small group of owners of so-called claw machines which are placed in various restaurants and other retail establishments in and about Baltimore. There are some two to three hundred of these machines in the Baltimore area. A number are also operated elsewhere, principally, I believe, in New Orleans, La., and San Francisco, Calif.

The claw machine works essentially on the same principle as a traveling excavating crane, as you can see from the photographs before you.

It consists of a miniature claw suspended from a boom located at the rear center of a glass-enclosed case, in which are displayed various articles of modest value, such as safety razors, flashlights, household tools, and so forth.

The lower end of the boom is hinged at the foot of a derrick or mast so that the boom may be moved forward or backward and from side to side, thus placing the claw in position to grasp and pick up a selected item of merchandise from among the articles visible in the display case. The cost of playing is 5 cents.

Success in operating the machine so as to obtain the desired article is dependent upon the player's skill and judgment, as I shall explain more fully.

Under section 3267 of the Internal Revenue Code, coin-operated amusement or music machines are subject to a special tax of $10 and so-called slot machines, whose successful operation depends upon chance, are subject to a tax of $150. The Bureau of Internal Revenue holds our claw machines subject to the $150 slot-machine tax. This tax would, of course, be raised to $250 by the House revenue bill, H. R. 4473.

The tax of $50 originally enacted in 1941 was not too difficult for us to sustain as a temporary war measure. But as a permanent feature of our revenue laws at the $150 rate, now to be increased to $250, it will force us out of business. Therefore we are here to save our business by asking that claw machines be removed from the slot machine classification. We seek only to be placed in a reasonable tax bracket suitable to the character and resources of our business.

The term "slot machine" is commonly used to mean the so-called one-armed bandit—a device of pure chance, insofar as the player is concerned, which is operated simply by inserting a coin and pulling a lever. We are not in that business nor in any way connected with it. It is entirely out of our league, not only in terms of the character of the machines used but also from the standpoint of scope of operations and comparative financial return on capital investment.

The application of the slot-machine tax to our business is not justified as an incident of a campaign of repression of gaming devices like one-armed bandits, because the claw machine is not a slot machine in that sense at all; nor is it justified as a revenue measure, because it is actually killing the source of taxes at which it is directed.

The tax has already caused the withdrawal from operation of hundreds of claw machines. This, in turn, has resulted in loss of revenue not only from the special tax but also from income taxes of owners of the machines, whose business has been curtailed or destroyed.

To operate the claw machine the customer turns the locator handle at the right center of the machine to the right or left, thus moving the boom and the claw so that the latter will be suspended at a point just above a desired article. The point from front to rear at which the claw will light is shown on an indicator at the rear of the machine. Having placed the claw in position, the operator inserts a nickel in the aperture at the left center of the machine, thus starting an electric motor which causes the boom to move forward and the claw to open and drop down. The claw closes when it has completed its descent. If the player is skillful the claw will grasp the desired object as it closes and deposit it in a chute which leads to a receptacle from which the player obtains the object. If it appears to the player that the claw will miss he can improve its position during its descent by spinning the locator handle to the right or left.

Every object in the case can be obtained by the player. His success depends on his skill in determining the correct angle of the boom for grasping a desired article and in manipulating and controlling it.

Senator MILLIKIN. Can he miss?

Mr. DOUB. He sure can, sir. If he does not position the claw strategically, he can expect to get nothing. If he does, and skillfully manipulates it, he will succeed.

The mechanism of the machine consists simply of an electric motor driving a cam shaft with three arms which are connected to the boom and claw. This mechanism has not been and cannot be set to govern either the percentage or the number of the merchandise units which will be grasped by the claw.

By contrast, the one-armed bandit and similar types are built to pay off at a predetermined percentage. All use the three-reel principle which you can see in the photographs which have been passed out. There is no skill involved in putting money in a slot and pulling a lever, and that is all the player does. His success is thus dependent entirely upon chance.

In determining whether a device constitutes a lottery or other game of chance the courts ordinarily apply the test of the dominating element. If the dominating element determining the result is skill, the machine is not a gaming device (*People* v. *Lavin*, 179 N. Y. 164; 71 N. E. 752, 755 (1904); 27 C. J. 968).

No claw-machine player expects a prize to turn up by the laws of chance. Instead, by means of the locator to which I have referred, he controls the position of the boom and claw, not only before the machine is set in operation by insertion of the nickel but during the entire time of its operation. It thus seems clear that the dominant element is skill. We, therefore, think that these machines would be more accurately classified as amusement and vending devices than as gaming machines like the one-armed bandit.

They are similar to coin-operated and manually controlled shuffleboard games and bowling games. These have been ruled by the Bureau to be games of skill subject to the $10 tax, in spite of the fact that a prize is offered for high score.

Permit me to describe briefly our method of doing business. The key factor is our ability to buy merchandise directly from the manufacturer at slightly less than 50 percent of its retail value. For example, on merchandise purchased for 45 cents the machine should return a gross of about $1.

Of this, 45 cents is, of course, allocable to the cost of the merchandise; another 25 cents is paid to the proprietor of the establishment where the machine is located; and 12 cents goes to the salesman who services the machines for us. These expenses amount to 82 cents, leaving a gross profit to the owner of the machine of about 18 cents, or 18 percent of the total collection. Out of this must come substantial amounts for Federal, State, and city taxes, and overhead. The Baltimore city tax alone is $65 per machine.

Our net profits, before personal taxes, will average less than 10 percent of the gross return of the claw machines owned by us. This is shown by the financial statements which I shall submit to the committee. The cost of the merchandise will be not less than 45 percent of the total collections from the machines, as the above example indicates. It is only because we buy directly from the manufacturer that we obtain a profit as substantial as the modest one shown by our statements. This is understandable when it is realized that, although the machines are still played for 5 cents, the cost of the merchandise has risen enormously since they were first used years ago.

In a sense, we are in a position comparable to that of jobbers marking up merchandise to the customer or player at a percentage which is customarily in ordinary business transactions. Every customer does not pay at the same rate because some are more skilled than others. But, on the average, the articles are disposed of by us at the going retail price.

From another point of view, the payment of a nickel to operate the claw machine is not unlike the purchase of a hunting or fishing license from the State or from the owner of a private game preserve.

Like the preserve owner, we find it profitable to sell licenses. The hunting or fishing license may or may not pay off in fish or game, depending largely upon the skill of the fisherman or hunter. It will always pay off, however, in the enjoyment of hunting or fishing. Certainly nobody would regard the sale of a license or right to fish or hunt as a gambling arrangement. Yet it is basically quite similar to the enterprise in which the owners of the claw machines are engaged.

We submit, therefore, that our machines are simply not a part of the gambling picture to which the $150 tax was intended to apply. Last year's collections of the slot-machine tax amounted, we understand, to about $10 million. Of this sum it is a safe estimate that no more than 1 or 2 percent came from those few claw machines which still remain in operation, in spite of the special tax.

The claw machine is entirely out of place, and cannot long maintain itself, in a company which can pay such a tax. We would appreciate this committee's recognition of our true position and the granting of relief by removing these machines from the slot-machine classification.

Senator HOEY. How much does it cost to take a try at the machine?

Mr. DOUB. Five cents.

Senator HOEY. How much can you win if you should use skill?

Mr. DOUB. Our articles run anywhere from 10 cents to roughly 3 or 4 dollars in retail values, sir.

Senator HOEY. I see. And you get 5 cents a try?

Mr. DOUB. Five cents a try.

Senator HOEY. If you are skilled at it you get something. If you are not, you miss?

Mr. DOUB. That is right.

I would like to say this, also, that previously to this tax I operated about a hundred machines. When this tax came into being it was $50, increased to $100, and last year increased to $150. I am now down to operating about 20 machines.

I have here a financial statement for the first 6 months of this year, and on a gross business of $39,531.45 I made a net profit of $570.82. That is not allowing for any salary for myself or any use of a building which I own in rent or anything else, and that seems to be the trend in our business. The tax has become and reached the stage where it is really confiscatory, and I feel, if the $250 tax now proposed goes into effect, it will amount to confiscating our business.

I have these statements here, financial statements from three of the operators who are operating.

Senator MILLIKIN. We will put them into the record.

Mr. DOUB. I thank you, sir.

(The documents referred to follow:)

Franklin Novelty Co.—Statement of income and expenses on claw-machine operations for the 6 months ended June 30, 1951

Income:		
Machine receipts		$36,531.45
Less merchandise used		9,744.84
		26,786.61
Less location owners' share		10,675.20
Gross profits on operations		16,111.41
Overhead expenses:		
Salaries and wages of employees		6,685.92
Employees' auto and service expenses, etc		418.75
Repairs and maintenance of machines and equipment		1,830.00
Automobile expenses, owner		370.46
Heat and light		200.04
Depreciation		1,140.02
Telephone, telegraph, and postage		391.21
Printing, stationery, and office expense		18.25
Legal and accounting		150.00
Insurance		357.95
Freight in		304.53
Ground rent		85.50
Traveling expenses		421.74
Taxes, payroll		62.35
Taxes and licenses, machines:		
Federal tax, 28 machines, at $150 per year	$2,100.00	
City tax, 16 machines, at $65 per year	520.00	
County tax, 12 machines, at $25 per year	150.00	
		2,770.00
Miscellaneous expense		323.27
Total expenses		15,540.59
Net profit		570.82

NOTE.—Building and office rental expense, ordinarily an expense of operations, is not included in this statement. No deduction was taken in this statement for owners or proprietor's salary.

Novelty Sales Co.—Operating income on claw machines for 6 months ended June 30, 1951

Gross income		$127,202.33
Commissions paid to locations		31,800.58
Income less commissions to locations		95,401.75
Cost of income:		
Inventory Jan. 1, 1951	$30,083.47	
Purchases	78,999.00	
Total	109,082.47	
Inventory June 30, 1951	65,235.42	
Cost of income	43,847.05	
Add commissions	14,031.48	
Employees expense	4,502.12	
Total cost of income		62,380.65
Gross income		33,021.10

Novelty Sales Co.—Operating income on claw machines for 6 months ended June 30, 1951—Continued

Expenses:		
Machine expense	$850.00	
Supplies	800.00	
Salaries and wages	8,092.11	
Telephone	734.72	
Hardware and parts	3,470.00	
Installation and repairs	800.08	
Office expense	370.52	
Auto and truck expense	356.08	
Advertising and promotion	427.15	
Heat, light, and power	340.92	
Rent, storage	55.00	
Hauling	86.00	
Insurance	580.46	
Shop expense	215.50	
Transportation	45.00	
Miscellaneous expense	83.70	
Depreciation	1,151.94	
Payroll taxes	356.37	
Licenses, Federal, city, and county	5,963.39	
Admission tax	654.20	
Retail sales and use tax	886.00	
Total expenses		$26,356.70
Net profit		6,664.81

NOTE.—This statement does not include any salary to owner.

Gift Novelty Co.—Claw machine operating profit and loss statement for the 6 months ended June 30, 1951

Gross income		$120,617.60
Commission paid location		31,654.40
Income		88,963.20
Cost of income		
Inventory Jan. 1, 1951	$23,331.46	
Purchases	69,367.14	
Total	92,698.60	
Inventory June 30, 1951	51,533.13	
Cost of income	41,165.47	
Add commissions	12,185.53	
Employees expense	4,367.99	
Total cost of income		57,718.99
Gross income		31,244.21
Expenses:		
Machine expense	$700.00	
Salaries and wages	6,941.99	
Stationery and office expense	308.79	
Installation and repair	271.62	
Shop expense	231.99	
Hardware and parts	2,506.69	
Supplies	364.88	
Taxes, Federal, State, and local	4,959.67	
Use tax	993.64	
Amusement taxes	633.09	
Social-security taxes	410.47	
Miscellaneous taxes	6.05	
Telephone and telegraph	279.43	
Light, heat, and power	177.00	

Gift Novelty Co.—Claw machine operating profit and loss statement for the 6 months ended June 30, 1951—Continued

Expenses—Continued		
Automobile and other transportation	$605.58	
Insurance	004.00	
Hauling	30.05	
Advertising and promotion	788.67	
Miscellaneous expense	40.36	
Locations	20.00	
Legal and auditing	114.00	
Storage	98.90	
Leasehold expense	724.87	
Depreciation	693.09	
Totals expenses		$23,081.73
Net operating income		14,162.48

NOTE.—Partnership: No salaries to partners included.

Senator MILLIKIN. Mr. Osherman of the National Ballroom Operators Association.

STATEMENT OF J. A. OSHERMAN, ACCOMPANIED BY THOMAS B. ROBERTS, REPRESENTING THE NATIONAL BALLROOM OPERATORS ASSOCIATION

Mr. OSHERMAN. My name is J. A. Osherman. I represent the National Ballroom Operators Association as Washington counsel.

This association is composed of the owners of ballrooms in 27 States, and the number of ballrooms so represented is approximately 200, comprising 90 percent of the important ballrooms of the entire country.

Mr. Roberts, who is general counsel of the association, from Des Moines, Iowa, is also here with me.

Our position is simply that Congress never intended to classify ballrooms under the cabaret tax, and the House, in section 404 of H. R. 4473, gave us that relief.

The amendment and the committee report are set forth in our statement, and the effect of this committee report is that the principle laid down in the *Geer* case, Geer against Birmingham, should control, rather than the principle of the *Avalon* case. The *Geer* case held that a ballroom was not a cabaret. The *Avalon* case, held that a ballroom was a cabaret.

The effect of that amendment is to confirm the fact that Congress had never intended to tax ballrooms as cabarets; that has always been the law prior to the *Avalon* case, and was recognized by the Bureau of Internal Revenue in numerous rulings given ballroom operators.

Gentlemen, the relief which we seek is not ordinary relief from an excise-tax inequity but a confirmation of what has always been the intent of Congress as shown by the legislative history of section 1700 (e) of the Internal Revenue Code.

While it is submitted that the reasons given by the House committee in its committee report for the enactment of section 404 of H. R. 4473 are alone sufficient to warrant your enactment of the same amendment, nevertheless we believe that we can demonstrate conclusively that your failure to enact such an amendment will radically reduce revenue and thereby defeat the very purpose of the new revenue act.

Ballrooms, as they are commonly known, are not cabarets, never have been cabarets, and never will be. No better indication of the correctness of this statement can be had than the fact that they are not considered cabarets by the American Federation of Musicians, the American Society of Composers, Authors, and Publishers, and amusement-trade publications. As we all know, a ballroom is fundamentally a place to dance and the primary purpose of those who attend such an establishment is to engage in dancing. The sale of such minor items as soft drinks, pop corn, and candy bars is for the convenience of the patrons and, as such, is purely incidental. No patron frequents a ballroom solely for the purpose of partaking of refreshments. A cabaret, on the other hand, is a place, as Judge Graven pointed out in the case of *Geer* v. *Birmingham*, which the public usually and generally patronizes for purposes other than dancing, such as to see the floor show, entertain guests, and partake of food and drink. For more than 30 years prior to the *Avalon* case, ballrooms were classified under section 1700 (a) of the Internal Revenue Code, the same as skating rinks, movie theaters, baseball and softball games, amusement parks, boxing and wrestling shows, horse and dog races, circuses and carnivals, autocar races, high-school and college athletic events, concert halls, and legitimate theaters. In every one of those places of amusement soft drinks and refreshment items, such as pop corn, peanuts, and candy, are available to patrons as merely incidental to the entertaiment offered. Only an admissions tax has been levied and is now levied on each of the foregoing places of entertainment.

It affirmatively appears that while the incidental relationship between the sale of refreshments to the form of entertainment offered in ballrooms is the same as the incidental relationship between the sale of refreshments and the form of entertainment offered in each of the foregoing establishments, the effect of imposing an extra tax on the sale of refreshments in ballrooms is to single out ballrooms and thereby discriminate against them in favor of all other competitive places of entertainment wherein the sale of refreshments is likewise incidental to the entertainment furnished. We make that statement as to competition because a ballroom, like these other establishments above-mentioned, is primarily a poor man's place of entertainment as compared to a cabaret which is frequented almost entirely by people of far more means. It is well known that prices charged for refreshments in a ballroom do not exceed those charged for the same items by ordinary retail outlets, while the prices charged for the same items in cabarets are many times higher than those charged by such outlets.

The legislative history of section 1700 (a) and section 1700 (e) for over 30 years, as summarized by District Judge Graven in *Geer* v. *Birmingham*, shows that the admissions tax was intended to tax those places of entertainment which make a charge at the box office fairly reflecting the value of the entertainment offered. Cabarets might have been placed in this same category except for the fact that they do not charge an admission at the box office but include the cost of the entertainment in the prices of the food and drinks and consequently a special tax had to be designed for them.

To place ballrooms in the same category as cabarets is in effect to subject them to confiscatory double taxation, inasmuch as one tax is imposed at the box office on the price of the entertainment and another tax for the same purpose is imposed on the charges for refreshments. These charges, unlike those in a cabaret, are not increased to include the cost of the entertainment offered. Obviously, ballrooms cannot survive such manifestly unfair and grossly discriminatory taxation while their afore-mentioned competitors, appealing to the same class of patrons, pay but a single tax levied only on their admission charges.

Taxing ballrooms under section 1700 (e), instead of section 1700 (a), is already having a disastrous effect on the entire industry. As proof of this fact, we have with us several letters from ballroom operators in which they state that they have either gone out of business or are contemplating going out of business. To read all of those letters to your committee would take more time than that allotted to us, so we have appended to this memorandum copies of those letters. The originals, of course, are available for your examination. The gist of those letters, of which the letter appearing on page 6 of our statement is typical, is that attendance has fallen off entirely due to the tax and such tax is so highly discriminatory that patrons who formerly patronized ballrooms are now being diverted to other places of entertainment where incidental sales of refreshments are not subject to a cabaret tax.

As further proof of the deplorable state of the ballroom industry due to the imposition of the cabaret tax, the National Ballroom Operators Association has made a spot check of ballrooms in the States of California, Colorado, Illinois, Indiana, Iowa, Kansas, Missouri, Minnesota, Nebraska, Ohio, Oklahoma, Wisconsin, South Dakota, and Utah and found that 33 ballrooms have gone out of business, 14 ballrooms are contemplating going out of business, and 22 ballrooms have curtailed their nights of operation. The names of these ballrooms in their respective groups are shown on lists appended to this statement. In this same connection the following telegram was received yesterday from the association's managing secretary:

DES MOINES, IOWA, *August 2, 1951.*

J. A. OSHERMAN and T. B. ROBERTS,
Washington, D. C.:

As the result of a survey which I recently made of the ballroom business it is my opinion that a majority of the ballrooms of this country have been so adversely affected by the cabaret tax that they have either closed their doors, curtailed their operation, or are considering doing one or the other.

NATIONAL BALLROOM OPERATORS ASSOCIATION,
OTTO WEBER, *Managing Secretary.*

We know, as your committee knows, that it is just as important not to lose revenue as it is to increase revenue. We, therefore, come to the important consideration that unless the amendment in H. R. 4473 is enacted, ballrooms will be driven out of business with a large resultant loss of revenue.

In the year 1948 54 representative ballrooms in 17 States paid about $860,000 in admissions taxes. Were your committee to have before it the total admissions taxes paid by all the ballrooms in the 48 States, it would, of course, amount to several millions of dollars annually.

Having clearly shown that the effect of the discriminatory tax imposed by section 1700 (a) is to force ballrooms out of business and decrease the nights of operation, it necessarily follows that the admissions tax heretofore received by the Federal Government will be reduced to the extent of millions of dollars. Certainly no one familiar with the ballroom industry as a whole can, by the greatest stretch of the imagination, make the statement that the placing of ballrooms under the cabaret tax imposed by section 1700 (e) will result in any increase in revenue. This point can be graphically illustrated by the Archer Ballroom Chain, which operates seven ballrooms in South Dakota, Iowa, and Missouri. These ballrooms paid a total Federal admissions tax of $78,350.81 for the year 1950. Had it not been for the fact that the House enacted the amendment here in question, Mr. T. H. Archer, would by now have leased one of his ballrooms for other business purposes and, in the event the amendment does not become law, will be forced to do likewise with his other six ballrooms. That would result in a complete loss to the Government of admission taxes amounting to approximately $80,000 annually.

Many of these ballroom operators who have either gone or are going out of business are veterans, while others are people of small means who are losing their only means of livelihood. They complain bitterly about the fact that the corner movie theater, the roller-skating rink, ball park, and the stockcar race track in their same community pay only an admissions tax, and the further fact that many so-called private clubs operated by some veterans' group, lodge, or similar organization and in direct competition with ballrooms because they regularly put on public dances, pay no taxes whatever.

Many of our ballroom operators have voiced the complaints of patrons who like to go to ballrooms as a relaxation from their labors and who cannot now afford to do so. It all comes down to the fact, therefore, that the workingman and the young people with limited means are being deprived of wholesome and healthy entertainment. Certainly with all the current talk against juvenile delinquency it seems unfair to deprive young people of the opportunity of listening and dancing to good music in a wholesome environment and, instead, to drive them into the unwholesome atmosphere of many places frequented mainly by undesirable people. It must be remembered that every ballroom in our entire association is supervised by the police, something which cannot be said of the many pubs, dives, and undesirable honky-tonks which will be the only remaining places of entertainment which they can afford to patronize.

Gentlemen, we feel sure that should we fully pursue our rights for relief in the courts that the ambiguity in section 1700 (e) will be resolved in our favor. The wheels of justice, however, grind so slowly that by the time such relief comes it will be too late. We submit therefore that where such an ambiguity admittedly exists it is the duty of Congress to resolve that ambiguity, for the reasons we have stated, in favor of the ballrooms of the United States and thereby save an old and established industry upon whom the livelihood of thousands of people depend.

Senator MILLIKIN. The House has done it?

Mr. OSHERMAN. The House has done it.

Senator MILLIKIN. And you are in favor of our going along with the House?

Mr. OSHERMAN. Absolutely. I believe that Mr. Stam is familiar with the whole question, and it merely means that we ask you to confirm what had been done for 30 years, and by legislative history which shows the intent of Congress during that period.

Senator MILLIKIN. Thank you very much.

Mr. ROBERTS. Senator, letters are attached to our prepared statement.

Senator MILLIKIN. You may have the full statement, with all attachments, which you wish to add, put into the record.

Mr. OSHERMAN. Thank you.

(The prepared statement and attachments are as follows:)

STATEMENT OF J. A. OSHERMAN AND THOMAS B. ROBERTS, APPEARING ON BEHALF OF THE NATIONAL BALLROOM OPERATORS ASSOCIATION

Since Congress intended that bona fide ballrooms and other similar places be taxed under section 1700 (a) of the Internal Revenue Code rather than under section 1700 (e) of said Code, and the House in this Eighty-second Congress confirmed that intention by an amendment in H. R. 4473, this statement urges the Senate to enact the same amendment.

My name is J. A. Osherman. I am a member of the law firm of Gallagher, Osherman, Connor & Butler, Bowen Building, Washington, D. C. We are the Washington counsel for the National Ballroom Operators Association with its principal office in Des Moines, Iowa. The National Ballroom Operators Association is an organization composed of owners of ballrooms operating in 27 States and the number of ballrooms so represented is approximately 200, comprising 90 percent of the important ballrooms of the entire country.

I have with me today Mr. Thomas B. Roberts, of Des Moines, Iowa, who has assisted me in the preparation of this statement. Mr. Roberts is the legal counsel for the association and was the principal attorney representing the plaintiff ballroom operators in the case of *Geer* v. *Birmingham* (88 F. Supp. 189, and 185 F. 2d 82).

The House in section 404 of H. R. 4473 of this Congress, after careful consideration, excluded bona fide ballrooms from the provisions of section 1700 (e) of the Internal Revenue Code, which imposes a tax on cabarets, by inserting after the second sentence thereof the following new sentence: "In no case shall such term include any ballroom, dance hall, or other similar place where the serving or selling of food, refreshment, or merchandise is merely incidental, unless such place would be considered, without the application of the preceding sentence, as a 'roof garden, carbaret, or other similar place.' "

In the House committee report accompany said act, House Report 586 at page 126, the purpose of this amendment is stated to be:

"This section amends section 1700 (e) (1) of the Internal Revenue Code to exempt from the cabaret tax bona fide dance halls, ballrooms, and other similar places where the serving or selling of food, refreshments, or merchandise is merely incidental to the music and dancing privileges furnished, unless the conduct of the place is such as to bring it within the normal concept of a roof garden, cabaret, or similar place. This determination will be made by reference to the over-all operation of the establishment, including such factors as the relative income from the several activities over a period of time, the relative portion of space devoted to the various activities, the type of refreshments served or sold, the scope and character of the entertainment furnished, and the hours of operation.

"The purpose of this amendment is to make it clear that the principles set forth by the district court in the case of *Geer* v. *Birmingham* (88 F. Supp. 189) are controlling in the determination of whether the establishment involved is operating as a cabaret or as a dance hall, and to avoid the broad construction placed upon the statute in the case of *Avalon Amusement Corporation* v. *United States* (165 F. 2d 653), and in the court of appeals decision reversing the decision of the district court in the *Geer* case (*Birmingham* v. *Geer* (185 F. 2d 82), which require that dance halls and similar establishments be taxed as cabarets, even though the serving or selling of food, refreshments, or merchandise is merely incidental."

The effect of that amendment is to confirm the fact that Congress had never intended to tax ballrooms as cabarets. That had always been the law prior to the Avalon case and was so recognized by the Bureau of Internal Revenue in numerous rulings given ballroom operators.[1]

[1] Many of these rulings are set out verbatim on pp. 215 to 220 of Judge Graven's opinion in *Geer* v. *Birmingham* as reported in 85 F. Supp. 189.

Gentlemen, the relief which we seek is not ordinary relief from an excise-tax inequity but a confirmation of what has always been the intent of Congress as shown by the legislative history of section 1700 (e) of the Internal Revenue Code.[2]

While it is submitted that the reasons given by the House committee in its committee report for the enactment of section 404 of H. R. 4473 are alone sufficient to warrant your enactment of the same amendment, nevertheless we believe that we can demonstrate conclusively that your failure to enact such an amendment will radically reduce revenue and thereby defeat the very purpose of the new revenue act.

Ballrooms, as they are commonly known, are not cabarets, never have been cabarets, and never will be. No better indication of the correctness of this statement can be had than the fact that they are not considered cabarets by the American Federation of Musicians, the American Society of Composers, Authors, and Publishers, and amusement trade publications. As you know, a ballroom is fundamentally a place to dance and the primary purpose of those who attend such an establishment is to engage in dancing. The sale of such minor items as soft drinks, popcorn, and candy bars is for the convenience of the patrons and, as such, is purely incidental. No patron frequents a ballroom solely for the purpose of partaking of refreshments. A cabaret, on the other hand, is a place, as Judge Graven pointed out in the case of *Geer* v. *Birmingham*, which the public usually and generally patronizes for purposes other than dancing, such as to see the floor show, entertain guests, and partake of food and drink. For more than 30 years prior to the Avalon case, ballrooms were classified under section 1700 (a) of the Internal Revenue Code, the same as skating rinks, movie theaters, baseball and softball games, amusement parks, boxing and wrestling shows, horse and dog races, circuses and carnivals, auto-car races, high school and college athletic events, concert halls, and legitimate theaters. In every one of those places of amusement soft drinks and refreshment items such as popcorn, peanuts, and candy are available to patrons as merely incidental to the entertainment offered. Only an admissions tax has been levied and is now levied on each of the foregoing places of entertainment.

It affirmatively appears that while the incidental relationship between the sale of refreshments to the form of entertainment offered in ballrooms is the same as the incidental relationship between the sale of refreshments and the form of entertainment offered in each of the foregoing establishments, the effect of imposing an extra tax on the sale of refreshments in ballrooms is to single out ballrooms and thereby discriminate against them in favor of all other competitive places of entertainment wherein the sale of refreshments is likewise incidental to the entertainment furnished. We make that statement as to competition because a ballroom, like these other establishments above-mentioned, is primarily a poor man's place of entertainment as compared to a cabaret which is frequented almost entirely by people of far more means. It is well known that prices charged for refreshments in a ballroom do not exceed those charged for the same items by ordinary retail outlets, while the prices charged for the same items in cabarets are many times higher than those charged by such outlets.

The legislative history of section 1700 (a) and section 1700 (e) for over 30 years, as summarized by District Judge Graven in *Geer* v. *Birmingham*, shows that the admissions tax was intended to tax those places of entertainment which make a charge at the box office fairly reflecting the value of the entertainment offered. Cabarets might have been placed in this same category except for the fact that they do not charge an admission at the box office but include the cost of the entertainment in the prices of the food and drinks and consequently a special tax had to be designed for cabarets.

To place ballrooms in the same category as cabarets is in effect to subject them to confiscatory double taxation inasmuch as one tax is imposed at the box office on the price of the entertainment and another tax for the same purpose is imposed on the charges for refreshments. These charges, unlike those in a cabaret, are not increased to include the cost of the entertainment offered. Obviously, ballrooms cannot survive such manifestly unfair and grossly discriminatory taxation while their afore-mentioned competitors, appealing to the same class of patrons, pay but a single tax levied only on their admission charges.

Taxing ballrooms under section 1700 (e) instead of section 1700 (a), is already having a disastrous effect on the entire industry. As proof of this fact

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[2] This legislative history is fully set forth on pp. 195 to 215 of Judge Graven's opinion in *Geer* v. *Birmingham* as reported in 85 F. Supp. 189.

we have with us several letters from ballroom operators in which they state that they have either gone out of business or are contemplating going out of business. To read all of those letters to your committee would take more time than that allotted to us so we have appended to this memorandum copies of those letters. The originals, of course, are available for your examination. The gist of those letters, of which the letter appearing on page 6 of our statement is typical, is that attendance has fallen off entirely due to the tax and such tax is so highly discriminatory that patrons who formerly patronized ballrooms are now being diverted to other places of entertainment where incidental sales of refreshments are not subject to a cabaret tax.

MELODY MILL BALLROOM,
Dubuque, Iowa, July 24, 1951.

Mr. OTTO WEBER,
Managing Secretary, Des Moines, Iowa.

DEAR SIR: I am writing you to see if you can help correct a very unfair double taxation situation. We have operated a ballroom for many years with the admission price charged at the door as our principal source of revenue and we have paid the 20 percent admissions tax as required by Federal law, we have no complaint on just taxes but people simply rebel after paying their admission and tax they are forced to pay another 20 percent on hamburgers, pop, etc., when they can go next door and buy the same merchandise for 20 percent less.

Naturally this makes people feel that we are trying to gouge them because it is impossible to explain to every customer that it is the Government and not us who gets the extra 20 percent. For example, in this farm area entire families of 6 to 10 people attend our regular old-time dances and naturally the kids want a hamburger, a bottle of pop, and maybe a candy bar and we feel very, very cheap trying to explain why we must charge 20 percent more than any other place they go. We do not mind collecting taxes that are fair but this is the most unfair tax because it singles out ballrooms and does not apply to other forms of amusements such as ball games, races, carnivals, theaters, etc.

Why are we being discriminated against? What have we done to deserve special double taxation? Please advise us what can be done to get our lawmakers to realize the gross unfairness of this law.

Sincerely yours,

VINCE. SCHULTING, *Manager.*

As further proof of the deplorable state of the ballroom industry due to the imposition of the cabaret tax, the National Ballroom Operators Association has made a spot check of ballrooms in the States of California, Colorado, Illinois, Indiana, Iowa, Kansas, Missouri, Minnesota, Nebraska, Ohio, Oklahoma, Wisconsin, South Dakota, and Utah and found that 33 ballrooms have gone out of business, 14 ballrooms are contemplating going out of business, and 22 ballrooms have curtailed their nights of operation. The names of these ballrooms in their respective groups are shown on lists appended to this statement. In this same connection the following telegram was received yesterday from the Association's Managing Secretary:

DES MOINES, IOWA, *August 2, 1951.*

J. A. OSHERMAN and T. B. ROBERTS,
Bowen Building, Washington, D. C.:

As the result of a survey which I recently made of the ballroom business it is my opinion that a majority of the ballrooms of this country have been so adversely affected by the cabaret tax that they have either closed their doors, curtailed their operations, or are considering doing one or the other.

OTTO WEBER,
Managing Secretary, National Ballroom Operators Association.

We know, as your committee knows, that it is just as important not to lose revenue as it is to increase revenue. We therefore come to the important consideration that unless the amendment in H. R. 4473 is enacted, ballrooms will be driven out of business with a large resultant loss of revenue.

In the year 1948, 54 representative ballrooms in 17 States paid about $860,000 in admission taxes. Were your committee to have before it the total admissions taxes paid by all the ballrooms in the 48 States, it would, of course, amount to several millions of dollars annually.

Having clearly shown that the effect of the discriminatory tax imposed by section 1700 (e) is to force ballrooms out of business and decrease the nights of operation, it necessarily follows that the admissions tax heretofore received by the Federal Government will be reduced to the extent of millions of dollars. Certainly no one familiar with the ballroom industry as a whole can, by the greatest stretch of the imagination, make the statement that the placing of ballrooms under the cabaret tax imposed by section 1700 (e) will result in any increase in revenue. This point can be graphically illustrated by the Archer Ballroom chain which operates seven ballrooms in South Dakota, Iowa, and Missouri. These ballrooms paid a total Federal-admission tax of $78,350.81 for the year 1950. Had it not been for the fact that the House enacted the amendment here in question, Mr. T. H. Archer, he has advised us, would by now have leased one of his ballrooms for other business purposes and in the event the amendment does not become law, will be forced to do likewise with his other six ballrooms. That would result in a complete loss to the Government of admission taxes amounting to approximately $80,000 annually.

Many of these ballroom operators who have either gone or are going out of business are veterans, while others are people of small means who are losing their only means of livelihood. They complain bitterly about the fact that the corner movie theater, the roller-skating rink, ball park, and the stock-car race track in their same community pay only an admission tax and the further fact that many so-called private clubs operated by some veterans' group, lodge, or similar organization and in direct competition with ballrooms because they regularly put on public dances, pay no taxes whatever.

Many of our ballroom operators have voiced the complaints of patrons who like to go to ballrooms as a relaxation from their labors and who cannot now afford to do so. It all comes down to the fact, therefore, that the workingman and the young people with limited means are being deprived of wholesome and healthy entertainment. Certainly with all the current talk against juvenile delinquency it seems unfair to deprive young people of the opportunity of listening and dancing to good music in a wholesome environment and, instead to drive them into the unwholesome atmosphere of many places frequented mainly by undesirable people. It must be remembered that every ballroom in our entire association is supervised by the police, something which cannot be said of the many pubs, dives, and undesirable honky-tonks which will be the only remaining places of entertainment which they can afford to patronize.

Gentlemen, we feel sure that should we fully pursue our rights for relief in the courts that the ambiguity in section 1700 (e) will be resolved in our favor. The wheels of justice, however, grind so slowly that by the time such relief comes, it will be too late. We submit therefore that where such an ambiguity admittedly exists it is the duty of Congress to resolve that ambiguity, for the reasons we have stated, in favor of the ballrooms of the United States and thereby save an old and established industry upon whom the livelihood of thousands of people depend. That legislative relief is badly needed and needed now.

CONCLUSION

In conclusion we respectfully urge that your committee recommend enactment of section 404 of H. R. 4473 into law.

EHLERS-GERKEN POST, NO. 694,
Arcadia, Iowa, July 26, 1951.

Mr. OTTO WEBER,
Managing Secretary, Des Moines, Iowa.

DEAR SIR: The executive committee of our local Legion post has requested that I write to you concerning the cabaret tax which we have been paying on all refreshments and services at the ballroom which is owned and operated by the post here in Arcadia, Iowa.

Since our ballroom was built in 1948 (by the post, composed entirely of veterans of World Wars I and II) until the time the cabaret tax was levied, we were able to show a fair profit from our operations. We have always tried to keep our operating expenses at the lowest possible figure and in most cases using members from the post and the auxiliary of the post to act as waiters, waitresses, ticket sellers, and check-room employees. Because of their interest in the post and the community in general, these people have worked for from $3 to $5 per night. All our other operating expenses have been held to the very minimum in an effort to at least try to show a profit at the end of the year. Our prices have been as high as we feel we dare go without hurting business too seriously. In other words, when the cabaret tax was levied instead of increasing our prices, we absorbed the tax ourselves.

To clarify, I should like to quote a few figures. From November 22, 1949, through June 30, 1951, we have paid $7,520.10 in cabaret tax. The figure, of course, represents 20 percent of our gross receipts. In addition to this, we have collected $9,378.67 in admission taxes. This makes a total of nearly $17,000 paid in Federal admission and cabaret taxes in less than 2 years' time. In comparison to many other ballrooms the country over, ours is a small concern. During our fiscal year (March 1, 1950, to March 1, 1951) our gross income was $78,000 yet, after holding our overhead to the very least figure, our financial statement for the end of the year showed a loss. The ironic part of it all is that had we not had to pay the unfair cabaret tax, we could have shown a profit for the period.

In conclusion, I should like to say that it all boils down to one thing. If we must continue to pay the cabaret tax, I am almost certain that our ballroom will close. Any suggestions or help you can give us along this line will be sincerely appreciated.

Very truly yours,

LEO C. SCHWEERS.

RIVERSIDE RANCHO,
Los Angeles 27, Calif., July 23, 1951.

Mr. OTTO WEBER,
Managing Secretary, National Ballroom Operators Association,
Des Moines, Iowa.

DEAR MR. WEBER: Would certainly like to know what we ballroom operators can do toward eliminating the cabaret tax imposed on ballrooms where the revenue derived is from ballroom dancing mainly. The overhead in maintaining our place of business has naturally increased in cost, and our admission price of course cannot be increased, therefore, with the increases in salaries of musicians, employees, and maintenance, we find the burden of the cabaret tax so great that it has come to the point of either going out of business as so many of our competitors on the Pacific coast have or selling out.

Personally I find that I am in business merely to pay salaries, taxes, and cost of operating a ballroom and have to seek a different way of earning a living, Mr. Weber, unless I can get some relief from this taxation.

Hope you can find some way of keeping the ballroom operators from folding.

Sincerely yours,

RIVERSIDE RANCHO,
By MARTY LANDAN,

CASSVILLE, WIS., *July 24, 1951.*

Mr. OTTO WEBER,
Des Moines, Iowa.

DEAR SIR: I wish to register a complaint against the cabaret tax on ballrooms.

Ballrooms sell dancing; the refreshments are just an accommodation to our patrons, as are the refreshments sold at a ball park, for their baseball fans.

We have lost money the last few seasons but still had to pay cabaret tax on the refreshments sold.

It isn't the profit that is taxed, it's the total sales cost and profit. Twenty percent on cost and profit take nearly all the profit made.

The customer to a ballroom pays his tax when he enters the ballroom, and does not complain, but he does rebel when he pays tax on his refreshments and that's why ballroom business has lost out, they have been going elsewhere, where there is no cabaret tax.

I'm not a crank on taxes, but ballrooms are not cabarets. Ballrooms advertise bands and dancing, not refreshments.

Wishing you success,

Respectfully yours,

MR. and MRS. GEORGE PAPE.

THE ELMS,
Youngstown 2, Ohio, July 27, 1951.

Mr. OTTO WEBER,
Secretary, National Ballroom Operators Association,
Des Moines, Iowa.

DEAR MR. WEBER: In answer to your letter of July 22 inquiring about the East Market Gardens, I wish to inform you that we closed the East Market Gardens on June 1, 1951, and are converting it to a bowling alley.

I see no future in the ballroom business with the cabaret tax up in the air and also with the exemption of the so-called charity dances in the new tax bill.

In the last 12 months of operations we paid the Federal Government $5,608.07 in admission taxes. Had we been classified as a cabaret we would have paid $11,826, an increase of $6,218.58.

If the so-called charity dances are exempt they will be able to operate 20 percent cheaper than any legitimate ballroom which in effect is worse than the cabaret tax.

If they are looking for additional taxes why exempt the public who attend charity dances. If amusement taxes are to be collected why should they be collected from just certain groups. After all it is not the institution that pays the taxes but the individual who attends the dances.

So, all in all, the future looks too dark; therefore, the only thing left for us to do is to convert to another use for our buildings.

I will write you further at a later time, or see you at the next convention.

Respectfully yours,

L. A. CAVALIER, Jr., *Manager.*

CIMARRON BALLROOM,
Tulsa, Okla., July 25, 1951.

Mr. OTTO WEBER,
Des Moines 13, Iowa.

DEAR SIR: We have been in the ballroom business for the past 6 years and have used all types of bands and now operate the finest ballroom in the Southwest and pay more admissions taxes than any other ballroom in the State of Oklahoma.

Since it is illegal to sell refreshments in a ballroom in our State other than soft drinks and set-ups, the cabaret tax has worked such a hardship on us that it is almost impossible to operate. We charge only 1[illegible] cents for soft drinks and 30 cents for ice and 30 cents for white soda and ginger ale and since the cabaret tax went into effect our margin of profit has become so slim that unless something can be done to either eliminate the cabaret tax entirely or cut down on the admissions tax, I am afraid we will find it necessary to cease operations.

Sincerely yours,

C. M. COOKSEY, *Manager.*

AMERICANA CORP.,
Hollywood, Calif., July 2[illegible], 1951.

OTTO WEBER,
Secretary NBOA, Des Moines, Iowa.

DEAR SIR: We have been informed that the excise-tax revision is to come before the Senate Finance Committee in the near future.

We operate two ballrooms in southern California: the Harmony Park Ballroom and Hometown Jamboree. The present cabaret tax as it applies to ballrooms we believe is unfair and works such a hardship that we may have to discontinue the operation of the ballrooms if some relief is not given soon.

Sincerely,

AMERICANA CORP.,
STEVE STEBBINS,
President.

BOSTONIA BALLROOM,
Bostonia, Calif., July 25, 1951.

Mr. OTTO WEBER,
3208 Second Avenue, Des Moines, Iowa.

DEAR SIR: I am writing to inform you of the hardship of trying to remain in business due to the Federal admission and cabaret tax.

As you know the cost of advertising is sky-high, name bands and musicians are also very expensive. But I find that I must advertise very strongly to draw any people. Then the "take" on admission isn't enough to take care of the cost of advertising and payment of the band. Therefore, I am forced to absorb the balance of expenses from the sale of refreshments.

I can't raise the price of refreshments as the trade can't afford it. Therefore, I am forced to pay the Federal cabaret tax from the small profit of sales. As you can see it is becoming more difficult to remain in business.

Anything that could be done to help me remain in business would be greatly appreciated. Thank you.

Yours truly,

MICKEY WHALEN, *Owner-Manager.*

CHAMBER OF COMMERCE,
Bancroft, Iowa, July 26, 1951.

OTTO WEBER,
Manager-Secretary, N. B. O. A., Des Moines, Iowa.

DEAR MR. WEBER: Received your letter of July 12 regarding National Ballroom Operators Association dues. Am sorry to say we were forced to close our ballroom, almost 2 years ago.

The only dances we now have are wedding dances, these but once in a while, and always free. We don't even try to open our concessions for these dances.

Our ballroom opened in 1923, and although it was remodeled quite frequently we were always able to make a small profit which in return was spent for local community activities, such as youth's programs, junior legion baseball, Boy Scouts, etc.

The 20 percent admission tax and the 2 percent State tax hurt us plenty, but when the 20-percent cabaret tax was added on all merchandise, refreshments, and services there was nothing for us to do but close the ballroom.

If at any time we think we can see our way clear to reopen our ballroom, we will be more than pleased to again join the N. B. O. A.

Sincerely,

ANDY H. DIETERING,
Manager, Legion Ballroom.

THE PROM TERRACE BALLROOM,
Chicago, Ill., July 24, 1951.

MR. OTTO WEBER,
National Ballroom Operators Association,
3208 Second Avenue, Des Moines, Iowa.

DEAR MR. WEBER: As you no doubt know, in January we received a notice from the collector of internal revenue, Chicago, Ill., advising us that we should start charging the customers cabaret tax effective February 1, which we did.

Our business was already at a very low point and the reaction to this cabaret tax was so severe, it was necessary for us to give up our lease on May 12, 1951, and discontinue the operation of the ballroom.

Yours very truly,

ROY E. MCILRATH AND L. M. WATSON
(Doing business as:)
PROM TERRACE BALLROOM,
By ROY E. MCILRATH, *Partner.*

BALLROOMS WHICH HAVE BEEN CLOSED

Avalon, Remsen, Iowa
Crystal, Dubuque, Iowa
Smile House, Westside, Iowa
Town Hall, Westside, Iowa
Danceland, Missouri Valley, Iowa
Modernistic, Clinton, Iowa
Woodcliffe, Spencer, Iowa
Legion, Bancroft, Iowa
Oakwood, Wellman, Iowa
Act, Livermore, Iowa
Shimmers Lake, Grand Island Nebr.
Riverside Municipal Park, Beatrice, Nebr.
Birchwood Club, Omaha, Nebr.
Holiday, Joplin, Mo.
Tune-Town, St. Louis, Mo.
Prom Terrace, Fort Wayne, Ind.
East Market Gardens, Akron, Ohio
Ross's Danceland, Maywood, Calif.
Plamor, Los Angeles, Calif.
Uptown, Los Angeles, Calif.
Stewart Sisters, San Gabriel, Calif.
Avodon, Los Angeles, Calif.
Inglaterra, Peoria, Ill.
Gateway, McCook, Nebr.
Hub, Edelstein, Ill.
Pine Castle, Seymour, Wis.
Rainbow, Eyota, Minn.
Lake Marion, Brownton, Minn.
Orchid, Sleepy Eye, Minn.
Bass Lake, Winnebago, Minn.
Jewett's Point, Fairbault, Minn.
Flandreau Park, Flandreau, S. Dak.
Casino, Kimball, S. Dak.

BALLROOMS WHICH HAVE CURTAILED THEIR NIGHTS OF OPERATION

Coliseum, Oelwein, Iowa
L. Gilbertz (owner's name), Garnavillo Iowa
Lakeside, Guttenberg, Iowa
Tromar, Des Moines, Iowa
Val-Air, Des Moines, Iowa
Riverview, Des Moines, Iowa
Armar, Marion, Iowa
Surf, Clear Lake, Iowa
Arkota, Sioux Falls, S. Dak.
Ritz, Beresford, S. Dak.
Pla-Mor, Kansas City, Mo.
Schoonover (owner's name) Boise, Idaho
Rainbow Randevu, Salt Lake City, Utah
Rainbow, Denver, Colo.
Plamor, Lincoln, Nebr.
King's, Lincoln, Nebr.
West Randolph, Randolph, Nebr.
Danceland, O'Neill, Nebr.
Aragon, Chicago, Ill.
Trianon, Chicago, Ill.
Royal Palace, Galena, Ill.
New Moon, Wichita, Kans.

BALLROOMS THE OWNERS OF WHICH ARE CONTEMPLATING GOING OUT OF BUSINESS

Legion, Arcadia, Iowa
Cobblestone, Storm Lake, Iowa
Marcon, Iowa Falls, Iowa
Dance Island, Wahoo, Nebr.
Ballerina, Omaha, Nebr.
Harmony Park, southern California
Hometown Jamboree, southern California
Cimarron, Tulsa, Okla.
Riberside Rancho, Los Angeles, Calif.
Huntington Park, Los Angeles, Calif.
Coliseum, Benld, Ill.
White City Park, Herrin, Ill.
Wigwam, Beloit, Wis.
Spicer Pavilion, Spicer, Minn.

Senator MILLIKIN. Senator Dworshak is here. Please go ahead, Senator Dworshak.

Senator DWORSHAK. Thank you, Mr. Chairman.

Earlier during these hearings, Mr. Henry B. Fernald, chairman of the American Mining Congress, presented his statements earnestly urging some changes in the tax laws, and the changes that might be made in the consideration of new legislation.

I think that Senator George, of your committee, has received a letter from L. J. Randall, who is also a member of this tax committee of the American Mining Congress, and which letter has already been printed in your hearings.

At this time I should like to call attention to a letter received from the Idaho Mining Association, Boise, Idaho, and the Northwest Mining Association at Spokane, Wash., calling attention to the statement submitted to your committee by Mr. Fernald, and approving some of the recommendations which he has made.

I should like permission to insert these two letters in your hearings.

Senator MILLIKIN. They will be inserted. Thank you very much, Senator.

(The letters referred to follow:)

IDAHO MINING ASSOCIATION,
Boise, Idaho, July 30, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: We have examined a statement made by Henry B. Fernald, chairman of the American Mining Congress Tax Committee, dated July 18, 1951, made to your Senate Committee on Finance pertaining to the revenue bill of 1951, together with a letter to you dated July 24, 1951, signed by L. J. Randall, comptroller of the Hecla Mining Co., who is chairman of our tax committee. We have also examined a letter dated July 27 addressed to you as chairman of the Senate Finance Committee and signed by Mr. David E. Watson, vice president of the Northwest Mining Association at Spokane, Wash.

We not only endorse the statements made by Mr. Fernald, Mr. Randall, and Mr. Watson but we sincerely urge that your committee take action to amend our present Federal tax laws in accordance with their recommendations. In Idaho we are particularly interested in the recommendation that the tax laws be amended to permit a deduction for the cost of prospecting and exploration prior to discovery as an expense against other income in the year incurred. It seems to me that our whole defense program is largely dependent upon a ready source of metals.

I do not concur with the statement I have often heard by those not familiar with mining to the effect that our potential ore reserves have been exhausted. However, known metal reserves are being rapidly depleted, and unless some incentive is provided for continued prospecting and exploration, the industry will not be in a position to furnish metals so vitally needed for the national safety.

While the expensing of prospecting and exploration is vital, we also urge that you give consideration to the following recommendations made by Mr. Fernald and Mr. Randall:

1. Normal development costs to maintain production of an operating mine should be treated as an operating expense.

2. Net receipts from minerals produced prior to the productive stage should be applied as a reduction against prospecting, exploration, and development costs incurred prior to the productive stage.

3. The combined corporate normal and surtax rates should, in no case, be increased to a figure in excess of 50 percent of the net profits of the corporation, and the present excess profits tax credit based on income should be increased to 100 percent rather than reduced from the present 85 percent allowance to 75 percent as provided by the revenue bill of 1951 (H. R. 4473).

4. Code section 131 (f) which, under present law, grants a foreign tax credit only in the case of a majority-owned foreign subsidiary, should be amended to provide for an ownership requirement not in excess of 10 percent.

We urge that your committee act favorably upon the above recommendations.

Yours very truly,

HARRY W. MARSH, *Secretary.*

NORTHWEST MINING ASSOCIATION,
Spokane, Wash., July 27, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: We have just examined a statement made by Henry B. Fernald, chairman of the American Mining Congress Tax Committee, on July 18, 1951, to the Senate Committee on Finance, pertaining to the revenue bill of 1951 (H. R. 4473) on behalf of the mining industry in general. We have also examined a letter to you dated July 24, 1951, signed by L. J. Randall, comptroller of the Hecla Mining Co., and chairman of our tax committee, pertaining to the same subject.

Both of these men have emphasized the necessity for amendments to our present tax laws in order to encourage the discovery of new metal mines so vitally necessary at the present time for our national safety. We must urge that your Senate Finance Committee give careful consideration to the suggestions made by these two men. We are particularly interested in the following:

1. Our tax laws must be amended to permit a tax deduction for expenditures incurred in prospecting and exploration prior to discovery. The present law which permits a recovery of such expenditures only through depletion over ore reserves, if and when an ore body is discovered, does not serve as an inducement to expend funds for prospecting and exploration. I am sure that Dr. Boyd, Director of the Bureau of Mines, and other men familiar with the problems of the mining industry would certainly concede that such an amendment would immediately attract capital into the industry, and the resulting expenditures would unquestionably lead to discovery of new reserves to replace present reserves now being worked out.

2. Both Mr. Fernald and Mr. Randall point out that section 302 of the 1951 revenue bill is beneficial to some extent in that a deduction is permitted for development subsequent to discovery of a commercial ore body. However, they also note that no provision is made for the deduction of expenditures incurred prior to discovery, except through depletion. The proposed amendment, set forth above, is a must for the reason set forth. They also point out that section 302 might very well be interpreted to prevent the taxpayer from charging off normal development currently since the proposed bill states specifically that if the recovery of such expenditures is conditioned upon future production, duced ores or minerals benefited by such expenditures are sold." Such a requirement would obviously curtail the development of presently producing mines, and this is especially true in the case of a zinc property. The operator can hardly afford to risk capital for extensive development of an ore body for fear that if the recovery of such expenditures is conditioned upon future production, he may never secure the benefit of a tax deduction, which, of course, is true if the write-off must be made in a year when there is no profit. Expenditures to maintain production of an operating mine should not be considered as an expenditure for development, and such expenditures should be deductible as an ordinary cost of operation in the year such expenditures are made.

3. The proposal by Mr. Fernald and Mr. Randall that any net receipts from minerals produced prior to the productive stage should be applied as a reduction against cost of exploration and development prior to the productive stage is logical. Certainly the mine hasn't realized any operating profit until such time as the deposit is sufficiently developed to maintain a continuous production.

In conclusion, we are also in agreement with other suggestions by Mr. Fernald and Mr. Randall pertaining to any increase in the normal and surtax rates of corporations, and we certainly see no reason why the present excess-profits tax credit based on income should be reduced from 85 to 75 percent. In fact, it should be increased to 100 percent.

We were rather surprised to learn that code section 131 (f) grants a foreign tax credit only in the case of a majority-owned foreign subsidiary. Why make a 50-percent cut-off? Mr. Fernald points out that, for practical purposes, the ownership requirement should probably be a figure not in excess of 10 percent.

If your committee members could have an opportunity to visit the Coeur d'Alene district, I can arrange to have you visit as many of these mining ventures as you desire, and I think you would leave with a much more accurate picture of the problems confronting the mining industry, and the big problem of course is that present tax law just doesn't provide any incentive to attract capital so vitally needed for prospecting and exploration. I am sure that I could show you that not more than 1 mining venture out of 10, or perhaps 100, is ever successful. You wouldn't operate a slot machine if the bartender demanded 50 percent of every jackpot.

We urge that your committee take immediate action to amend the tax laws along the lines suggested by Mr. Fernald and Mr. Randall.

Yours very truly,

David E. Watson, *Vice President.*

STATEMENT OF RICHARD H. BALCH, PRESIDENT, HORROCKS-IBBOTSON CO., UTICA, N. Y.

Mr. Balch. Gentlemen, my name is Richard H. Balch, and I reside in Utica, N. Y. I am president of the Horrocks-Ibbotson Co., which is engaged in the manufacturing of fishing tackle and equipment. I appear on behalf of my own company and also on behalf of other manufacturers engaged in the manufacture of fishing tackle as we are.

We, in the fishing-tackle business appreciate the difficult task that confronted the House Committee on Ways and Means, and now confronts your distinguished committee, to raise revenue for the defense of the country.

If the revenue derived from the proposed increase of the excise tax on fishing rods, creels, reels, and so forth, from 10 percent to 15 percent were to be used in the defense of our country, we would have no complaint. Our situation, however, is entirely different. In a revenue bill designed principally to increase the tax receipts of the Government for the defense of this country, we find included therein a tax increase for "Fish restoration and management projects"—a field that must be conceded to be as far from defense as the North Pole is from the South Pole. It is my belief that the House Committee on Ways and Means proposed this tax in error. I am advised that when the committee removed the excise tax on such articles as children's toys and on sporting goods used principally at high-school level or lower, they increased the tax from 10 percent to 15 percent on other athletic and sporting goods, including fishing equipment, in order to make up the tax loss.

As I say, we would have no complaint if the tax imposed on us under the provision of H. R. 4473 was for the defense of the country like the tax on other sporting, athletic, and recreational goods. The House Committee on Ways and Means apparently overlooked, however, Public Law 681, Eighty-first Congress, second session, which established "Fish restoration and management projects," and under the law—

> there is authorized to be appropriated an amount equal to the revenue accruing from the tax imposed by section 3406 of title 26 on fishing rods, creels, reels, and artificial lures, baits, and flies during the fiscal year 1951 and each fiscal year thereafter.

I understand that there is a provision in the pending appropriation bill for the Department of Interior which implements the Fish Restoration and Management Project Act and freezes the tax receipts from fishing equipment for the purposes of fish restoration and management projects and that hereafter the item will not be included in any budget estimate or in any appropriation bill, but will be earmarked for those purposes only. So that I may the more clearly bring before you our complaint that the increased tax is not for national defense, permit me to read from Senate Report No. 2029 which accompanied the fish restoration and management projects bill before the Senate. I quote:

> The purpose of this bill is to inaugurate a program of Federal aid to the States for the restoration and management of their fishery resources, similar to that now in effect with respect to other wildlife under the provisions of the Pittman-Robertson Act of 1937 (50 Stat. 917; 16 U. S. C. 669). Under the Pittman-Robertson Act, wildlife-restoration programs are financed by the sportsmen of the country out of a special fund derived from a tax on firearms and shells and cartridges. Under this bill the proposed fish restoration and management projects would be financed by the fishermen enjoying the benefits of the program through a tax on fishing rods, creels, reels, and artificial lures, baits and flies. * * *

Now permit me to read the definition in the law:

For the purpose of this chapter the term "fish restoration and management projects" shall be construed to mean projects designed for the restoration and management of all species of fish which have material value in connection with sport or recreation in the marine and/or fresh waters of the United States. * * *

and the statute continues giving specific items included within the definition.

I submit that there is nothing even remotely connected between our national defense and sport and recreation in the marine and/or fresh waters of the United States. Yet under the guise of national defense, the excise tax on fishing equipment is increased 50 percent.

To further show that the distinguished Committee on Ways and Means inadvertently increased the tax on fishing equipment under the mistaken belief that the funds would be used for national defense, I wish to call your attention to the fact that for several months—I believe four—the Internal Revenue Department never even allocated the tax receipts to this new undertaking and is now in consultation with our industry in endeavoring to work out some reasonable allocation which apparently neither the Internal Revenue Department or the Department of Interior knew should be made.

After having inquiry made at the Interior Department, I am advised that the estimated revenue during fiscal year 1952 was $3,000,000 and the estimated expenditures were in the neighborhood of $2,100,000, leaving a surplus of $900,000.

Despite that surplus for fish restoration and management projects, the Ways and Means Committee has proposed to put upon us an additional 5 percent tax. I should point out, and this to my way of thinking is particularly important, that the Interior Department did not even request this increased tax although I have no doubt the money will be spent if the Department gets it, not for defense, but for the purposes set forth in the law—

in connection with sport or recreation in the marine and/or fresh waters of the United States. * * *

In pointing out again that these funds are not necessary for defense, I call your attention to the fact that they are under the law to be allocated to the States after sums not exceeding respectively, $75,000 for Alaska, 25,000 for Hawaii, and $10,000 each for Puerto Rico and Virgin Islands in any 1 year are deducted before any apportionment to the States. If the State has no projects which the Secretary of the Interior will approve, the State is just out of luck insofar as these funds are concerned. Any apportionment of the funds to the State must be expended or obligated within 2 years and if not, the funds are authorized to be made available to the Secretary of the Interior for expenditure, and I quote the law:

In carrying on the research program of the Fish and Wildlife Service in respect to fish of material value for sports and recreation.

Furthermore, I should like to state a few other pertinent facts. In 1947, the last year for which figures are available, the total amount of fishing tackle for sports sold at the retail level was $120,000,000.

There may be some discrepancy between my figure of three million and this but it is explained by the fact that only about half of the fishing tackle that is sold as sporting fishing tackle is taxable.

Items like tackle boxes and fishing lines and many other items are not taxable, and it is taxed, of course, at the manufacturers' level, which is about half at the retail level and that explains the discrepancy.

In the year ending June 30, 1950, the total volume of fishing tackle sales did not change very much.

In the meantime, the fishermen of the United States paid in 1950—the last year we have figures for—the various States for fishing licenses, resident and nonresident, the sum of $34,018,000.

In most States this revenue is earmarked for conservation projects so the proposed increase in the excise tax on fishing tackle, on the basis of last year's receipts and provided that the increased tax would not develop a sales resistance on the part of the consumer that might actually decrease the tax yield, would be approximately $1,500,000 which would be added to the present surplus of $900,000.

This is a heavy burden to put on our little industry, especially where the Government has a surplus in that account, and has not asked for this new tax. Increasing this tax to 15 percent might price rods and reels subject to the tax out of the market and would result in less funds for the above projects.

Gentlemen of the committee, I am a small-business man. The fishing tackle business is a small business, however, whatever hardship that we would have to bear by way of increased personal income taxes, by increased corporate and excess-profits taxes and by increased excise taxes too, which would be needed for the defense of our country, I and my company would gladly bear. But when, with increased personal income taxes and increased corporate and excess-profits taxes, we are penalized with a 50-percent increase in our excise taxes, when the receipts therefrom do not go to defense, when the department to which they are allocated has not even asked for an increase in our tax, when in fact, there is an unexpended surplus of nearly a million dollars in that account, and when this surplus may even increase, depending upon the ability and willingness of the States to embark on new fish restoration and maintenance projects, I submit that we have a legitimate grievance, and we should be relieved of the tax increase as proposed in H. R. 4473 on fishing rods, creels, reels, and fishing equipment generally.

Thank you.

Senator MILLIKIN. Mr. Stam, I suggest that you bring this matter especially to our attention during the executive session.

Thank you, Mr. Balch.

Mr. BALCH. Thank you very much.

Senator MILLIKIN. In lieu of an appearance the statements of the Southern States Industrial Council and Commonwealth Services will be inserted in the record at this point.

(The statements referred to follow:)

STATEMENT OF TYRE TAYLOR, GENERAL COUNSEL, SOUTHERN STATES INDUSTRIAL COUNCIL

The administration has asked for $10 billion in additional taxes.

This additional revenue is needed, it is said, for two reasons: (1) To prevent a deficit during the current fiscal year; and (2) to soak up excess purchasing power and thereby help check inflation.

This request is in addition to the two tax increases—aggregating $10 billion—imposed since the outbreak of the war in Korea.

The technical staff of the Joint Committee on Internal Revenue Taxation estimated in April that existing tax laws would yield $61 billion during the current fiscal year—or $16 billion more than was collected in any year of World War II. Some authorities now estimate this prospective tax yield at $62 to $63 billion.

On the spending side, the administration has proposed a budget for fiscal 1951–52 of $71.6 billion, which includes $40 billion for defense; $23 billion for nonmilitary purposes; and $8.6 billion for foreign military and economic aid. While it represents merely a postponement to future years, the administration now estimates that total Federal expenditures during fiscal 1951–52 will be $68 billion.

Based upon these estimates, the prospective cash deficit in fiscal 1951–52 without the enactment of any new tax legislation would be $7 billion, assuming total revenues of $61 billion, or $5 to $6 billion, assuming the higher estimate mentioned above.

If these figures are correct, it is clearly possible to avoid a deficit this fiscal year through a reduction in nonessential spending and without the necessity for imposing any additional taxes at this time. In his Atlanta speech on June 25, 1951, Senator Byrd stated that, "with the President's cooperation * * * the Federal budget as now proposed ($71.6 billion) could be trimmed to the extent of at least $8 billion without sacrificing a single essential Federal function."

Unfortunately, the President's cooperation is not likely to be forthcoming. While stating in a message to Congress in January that "the Government must practice rigid economy in its nondefense activities," he later—as Senator Byrd points out—proposed a budget that increased domestic civilian spending to the highest level in history. This budget he described as "tight" and "good" and dared Congress to cut it. The House—evidently convinced that Congress would not make the reductions necessary to avoid a deficit with its dire inflationary possibilities—passed a bill providing for $7.2 billion in additional taxes. More recently—on July 23 to be exact—Senators Taft and Millikin, distinguished minority members of this committee, expressed their conviction that no significant cuts would be made. "It just isn't going to be done," Senator Millikin said.

So we take it that there is going to be a tax bill and upon this assumption I shall submit several observations and recommendations at the close of this statement. Before going into that, however, I wish to explore further the prospective fiscal situation and outlook. For the purpose of this discussion, it is assumed (1) that we shall not become involved in a full-scale war with Soviet Russia; (2) that national income will continue at the present high level and even increase somewhat; and (3) that the defense build-up proceeds generally according to the plans already announced by the administration.

As already noted, the President's January budget contemplated the expenditure of $40 billion for defense this fiscal year. In his message of July 23 transmitting to Congress his midyear economic report, Mr. Truman stated that total security program costs have now reached an annual rate of more than $35 billion; that they are scheduled to increase to an annual rate of more than $50 billion by the end of this calendar year and to nearly $65 billion by the middle of next year.

If we assume no increase in domestic nonmilitary spending and foreign military and economic aid, this would mean that Federal expenditures for the next fiscal year will aggregate $96.6 billion. The highest Government expenditures for any year in World War II amounted to $98.7 billion, of which $84.5 billion was for prosecution of the war and $14.2 billion for civilian governmental activities. However, of this $98.7 billion, only $44.7 billion was raised in taxes and the deficit for 1944–45 was $53.9 billion. In a prior year—1943—with total expenditures of $79.6 billion, tax revenues amounted to only $22.2 billion and the deficit was $57.4 billion.

And here we come upon some fiscal facts of life that we feel have received far too little attention by Congress and the public. In compiling them, I was reminded of the man who jumped off the Empire State Building and upon being asked as he fell past a window on the fortieth floor how he was getting along replied, "All right so far."

Is a $96.5 billion budget fantastic? This astronomical sum would be sufficient to repair the damage of 96½ Kansas City floods—or two such floods for each of the 48 States. It is $5 billion more than the total of Federal receipts from the time of Washington to F. D. Roosevelt—144 years. But there are the figures—the $65 billion item for defense being Mr. Truman's own estimate. It should also be noted in this connection that, in addition to the $71.2 billion budget proposed for fiscal 1951–52, the President has requested new obligational authority up to $23.2 billion, bringing the total up to $94.4 billion. With the prospect of an increase in the Air Force to 150 groups costing $40 billion, the defense figure is not likely to be less than $65 billion. The other two items—$23 billion for nondefense activities and $8.5 billion for foreign military and economic aid—represent no increase over the proposed budget for the current fiscal year. Incidentally, the New York Times reported on July 26 that the ECA has now completed a master plan to revivify Western Europe.

Assuming total national income of $300 billion (it is running at an annual rate of $270 billion now), the prospect is that Federal spending will equal almost one-third of total income. And if State and local government spending is added—and assuming no increase in the current rate of $18 billion annually—the total becomes $114.5 billion—or 38 percent of national income.

Where is this money coming from?

Many industry-representing organizations—including the council—have strongly favored a pay-as-we-go policy of financing the defense program. The estimated yield of the bill passed by the House is $7.2 billion and if we adopt the $61 billion estimate of the tax yield under existing laws, the total would be $68.2 billion. A belief apparently generally held in the House is that this is the limit of Federal taxes our economy can support, Chairman Doughton, of the Ways and Means Committee, stating he considered it "unlikely that we shall be able to increase substantially the yield of the Federal tax system beyond what is included in the present bill."

If this is correct and the amount provided for in the House bill is finally approved, the indicated deficit for the next fiscal year is $28.4 billion. It is impossible to determine what this would mean in additional inflation and the further depreciation of the purchasing power of the dollar. In this respect we find ourselves in a position we have never occupied before in that as we start this rearmament and preparation for possible war, the Federal debt is more than a quarter of a trillion dollars. We are also starting this program with a dollar worth only 54 cents in terms of its 1940 purchasing power and still declining in value. These factors introduce into the situation an element of rigidity that has never been present before and the implications of which are not yet generally understood. It is no longer possible for us to fight or prepare for world wars largely on credit without producing a paralyzing inflation.

But suppose a serious attempt should be made to pay as we go and to collect nearly $100 billion annual in Federal taxes. Just as the thirty-eighth parallel separates communism from noncommunism in Korea, there is a tax parallel which separates free enterprise from socialism. Most economists draw this line—i. e., the total tax burden that an economy can support and still preserve free enterprise—at from 25 to 30 percent of national income. In socialist Britain, it is now 40 percent. As already noted, if State and local expenditures are included the total cost of Government under the spending program in prospect would be 38 percent, or more than enough to destroy the free-enterprise system in this country.

Another factor that must be taken into account is that of the duration of the emergency. You and I can carry a load across this room that we could not carry to Alexandria or even to the Union Station. Similarly, the national economy could support a much larger tax load for a year or two without destroying the free enterprise system than it could support for 4, 5, or 10 years. Yet, so far as we can see now, the present emergency is one of indefinite duration. We are told on the highest authority that it may last for a generation or longer.

Mr. Truman and others attempt to minimize the impact of this program upon the lives of the people by asserting that, at its planned maximum, it will divert to defense purposes only 20 percent of national production, as compared with roughly 45 percent at the height of World War II. However, the difficulty with this line of reasoning is that in World War II we only taxed ourselves on an average of 18 percent of our national income, while spending 42 percent. As already noted, we mortgaged the future during World War II and this credit leway is no longer available to us. The present program must be paid for—in taxes or savings or both. The result—the only possible result—will be a greatly lowered scale of living for the overwhelming majority of the people and this bleak prospect is something a politically sensitive administration is understandably reluctant to talk about or face up to.

How long will the American people find life in a garrison state tolerable?

Do we have the moral and physical stamina to surmount the worst crisis in our history and preserve our freedom?

Only time will tell. But in considering these somber facts, several thoughts occur:

1. Whatever the cost, we must build an impregnable national defense. On this we have no choice if we are to survive.

2. Government waste—unnecessary Government spending—is as much an act of sabotage against the American people as would be the destruction of an atom bomb plant. A dollar that is wasted by the Government is much more inflationary than when left in private hands. And here the responsibility of Congress is clear. To be sure, the job would be made much easier if the President would cooperate. But the President can spend only what the Congress appropriates. It holds the purse strings. Any time Congress makes up its mind to stop the waste in both civilian and military spending, it can do so.

3. The supreme problem is how to ride out and eventually surmount this crisis without losing our freedom. Some taxes are far more destructive of free enterprise than others. For example, a broad tax on consumption would be less destructive than near-confiscatory and incentive-killing income taxes on individuals and corporations. The latter—and especially excess-profits taxes—are also highly inflationary.

4. At best—and after all the nonessentials have been eliminated—the tax burden will be crushing. The people are going to have to make sacrifices greater than they have ever before had to make and this irrespective of whether their scale of living is depressed through confiscatory taxes or inflation. In these circumstances, they are entitled to a wide and equitable distribution of the total tax burden. Special tax advantages—such as are now enjoyed by the cooperatives and by the President, Vice President, and Members of Congress—must be paid for in additional taxes on all other taxpayers.

World War II Federal expenditures, taxes, deficits, production, and income

Period	Total Federal expenditures [1]	National defense expenditures [1]	Total Federal receipts [1]	Yearly deficit [1]	Gross national product [2]	National income [2]	Total expenditures as a percent of national income	Total receipts as a percent of national income
	Millions	*Millions*	*Millions*	*Millions*	*Millions*	*Millions*		
1942	$34,290	$26,846	$12,799	$21,491	$159,000	$136,500	25	9
1943	79,622	70,207	22,201	57,420	192,000	168,300	47	13
1944	95,315	83,706	43,892	51,423	212,200	182,400	52	23
1945	98,703	84,569	44,762	53,941	213,400	181,700	54	24
1946	60,703	45,134	40,027	20,676	209,300	179,300	34	22

[1] Source: Bureau of the Budget.
[2] Source: Department of Commerce.

COMMONWEALTH SERVICES, INC.,
New York, N. Y., August 3, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Chambers, Washington, D. C.

DEAR SIR: The undersigned, vice president of Commonwealth Services Inc., 20 Pine Street, New York, N. Y., respectively submits for your consideration a statement concerning the unfair and inequitable impact of the excess-profits-tax law upon this corporation.

Commonwealth Services is a company which has a long history as a service company rendering services through its staff of experts in a number of fields such as accounting, financial, rates, purchasing, insurance, etc., and wholly owns a subsidiary organized in Michigan in 1949 which renders engineering services. It was formed in March 1930, under the then name of The Commonwealth & Southern Corp. (New York) by the consolidation of certain predecessor service companies. Both these predecessor service companies and the consolidated company made normal profits, until 1931 when the operations of the consolidated company were changed to a cost basis as the service company for the Commonwealth & Southern Corp. (Delaware) public-utility system. In 1938 the service company came under the jurisdiction of the Securities and Exchange Commission pursuant to the Public Utility Holding Company Act of 1935, and was approved as a mutual service company on a cost basis rendering services only for the system, and so continued until the conclusion of the integration proceedings before the SEC, whereupon it became, on November 1, 1940, an independent service company owned by its employees, and the name changed to Commonwealth Services, Inc. It is only since November 1, 1940, that the independent company has operated on a profit basis.

A service company, by the very nature of its business, has a small capital since its most valuable asset is its experienced and expert personnel, and ordinarily, as an independent service company, would compute its excess-profits tax credit on the basis of its average earnings during the base period. Its requirement for capital consists principally of current accounts receivable and payroll. However, by reason of the fact that the service company did not become a profit organization until the last 2 months of the base period, it does not have the average earnings during the base period of independent service companies which became such at earlier dates, with the approval of the Securities and Exchange Commission, or otherwise.

Commonwealth Services is thus forced to relay for its excess-profits credit on its small amount of invested capital, as it does not seem to qualify for any of the so-called relief provisions of the act. Even if the company comes within one of the "relief" credits, the tentative industry rates of return for "Miscellaneous business services" or "Other services," as promulgated by the Secretary of the Treasury pursuant to the act, are grossly inadequate for an independent service company, inasmuch as apparently they cover service companies of a nonprofit character and many types of establishments which are in no way similar to a service company of the type of Commonwealth Services, Inc.

We believe that a corporation such as ours which was in existence during the entire base period but operated practically the entire base period on a nonprofit basis and then changed its method of doing business to a profit basis late in the base period (November 1, 1940), and now does a normally profitable business on a small capitalization, requires an adequate industry rate of return to base its credit upon. Only by this method can this company obtain fair and equitable treatment under the act.

Under the present law the corporation is apparently forced to file under the "invested capital" method, and it seems apparent that a corporation filing its excess-profits-tax return under the "historical invested capital method" cannot change to another more favorable method for that year, and accordingly, any amendment giving relief should provide that a taxpayer filing on the "historical invested capital basis" should have the right to switch to a more favorable method. This restriction is presently applicable to only the "historical invested capital method" and there appears to be no reason for this restriction.

Respectfully submitted.

W. B. TIPPY, *Vice President.*

Senator MILLIKIN. Mr. Berg.

Will you identify yourself, Mr. Berg, and make yourself comfortable.

STATEMENT OF RUDY BERG, CHAIRMAN, EXCISE TAX COMMITTEE OF REFRIGERATION EQUIPMENT MANUFACTURERS ASSOCIATION

Mr. BERG. My name is Rudy Berg. I am assistant sales manager of Copeland Refrigeration Corp., Sidney, Ohio. I appear here as chairman of the excise tax committee of the highside equipment section of the Refrigeration Equipment Manufacturers Association, known as the REMA.

REMA is composed of 120 manufacturers of refrigeration and air-conditioning parts, supplies, and equipment. The highside equipment section of REMA is composed of manufacturers of taxable and nontaxable refrigeration component parts—including condensing units, compressors, and motor-compressors—which are sold to manufacturers, wholesalers, jobbers, and dealers. We have two amendments to H. R. 4473 to submit for your consideration.

I should like to preface the amendment comments here by having noted that previous presentations at this hearing have referred to the essentiality of product. In that case I think it would be well to go on record that refrigeration is probably as vital from an essential standpoint of food. However, again, our appeal here is in connection with amendments.

Under the Internal Revenue Code—section 3405 (b) as amended by the Revenue Act of 1950—and the regulations thereunder Treasury Regulations 46, with amendments currently proposed, see Federal Register of May 10, 1951, the manufacturer of such component parts as I have mentioned, and which are otherwise taxable, may sell them tax-free under exemption certificate to a manufacturer of end products such as refrigerators and freezers—whether or not such end products are themselves taxable. With one exception noted below, there is, however, no exemption applicable to sales by or to wholesalers who resell to the manufacturers of end products—unless any such wholesaler qualifies as a "manufacturer" by reason of the fact that he also assembles complete end products.

The exception mentioned relates to wholesalers who are specifically registered with the Bureau of Internal Revenue as vendees of articles for resale to manufacturers; see Internal Revenue Code, section 3442, and Regulations 46, section 316.20–23. Registration under section 3442 is limited to wholesalers who resell to manufacturers of taxable end products.

The manufacturers of these taxable component parts are substantially dependent on the stocking and credit facilities of the wholesalers and jobbers representing their equipment in strategically located cities throughout the United States. These wholesalers, of course, carry inventories of the products they represent in order to serve the field needs of smaller manufacturers who are not and cannot economically be served direct.

It is our contention that in applying the excise tax to refrigeration equipment, it was not the intent of Congress to change any established medium of distribution then in effect. The present discrimination against the wholesaler, however, imposes a costly and forced change in long-established distribution channels, and disrupts relations of long standing between manufacturers of taxable refrigeration equipment and their wholesalers. The wholesalers and jobbers in our industry represent a business of integrity and a vital medium of distribution, particularly for the smaller manufacturers.

We appeal for an amendment to the House bill to cover the following points:

1. To permit a wholesaler to accept an exemption certificate from a qualified manufacturer, and in turn extend a similar exemption certificate to his manufacturing supplier, in order to permit him to purchase, tax-free, equipment which is to be furnished specifically to meet an order for which he has an exemption certificate from his manufacturing customer.

2. To permit a wholesaler to extend an approved exemption certificate to his manufacturing supplier for credit of tax paid on equipment sold under exemption certificate from his stock to a qualified manufacturing account customer.

That composes under the first amendment that we appeal for the two relief measures desired.

I should like to state here that the manufacturers have spent years and considerable expense to set up these stocking wholesalers throughout the Nation, so as to efficiently and economically serve their customers and equipment users.

If you are living in the far West and you needed a new component or a replacement of some defective item, you would not want to wait weeks to obtain it. The stocking wholesaler, we must keep in mind, is invariably the small independent businessman and he supplies this efficient localized service and availability.

He, too, has spent much in time and money cultivating his territory. It is conceivable, therefore, that with one fell swoop his elected representatives of Government could impose legislation that would be a curtailment of his long-established accepted channels of doing business.

Incidentally—and I will refer again to my bulletin, the foregoing facts were discussed on January 3, 1951, during a joint meeting of a committee of manufacturers and wholesalers with officials of the Bureau of Internal Revenue. We assume that your staff members will, as a matter of routine, ascertain the position of the Bureau on this proposal. We cannot, of course, in any way speak for the Bureau, but we believe you will find that the Sales Tax Division is sympathetic to this problem.

I believe that the Bureau, if objecting at all to relief to the wholesaler under this measure, would do so solely on the premise that it would add to policing problems.

On amendment No. 2, where a component part, such as the motor-compressor of a taxable type refrigeration unit, is returned to us, out of warranty, for repair, no tax applies if the identical returned motor-compressor of the customer is repaired and returned to the customer.

When so handled, however, the cost of repair is greater because of the individual handling necessary.

Furthermore, the customer is without the use of his equipment while the compressor is enroute to and from the factory and during that time required for repair.

In the interest of lowest possible prices to the user and to minimize "out of use" time, manufacturers have been following the practice of furnishing—through their stocking wholesalers or jobbers, or on occasion for immediate direct shipment from the factory—an exchange compressor of the same type obtained from a common repair pool stock at a flat rate price. Present Internal Revenue rulings are that when so handled from a repair pool, the tax applies and is not even limited to the cash amount received; the tax being based on the manufacturers' established selling price of the same type compressor when sold new.

It is our contention that it was not the intent of the Congress to impose a tax which is, in substance, a penalty on user-maintenance of existing essential food preservation equipment. It seems to us that the tax should not apply in this situation, since it is in substance the equivalent of the ordinary repair job, which is not taxed.

We have attached, for the consideration of your draftsman, suggested statutory language to meet the problems we have discussed.

Senator MILLIKIN. Thank you very much.

The amendments you referred to will be inserted in the record at this point.

(The amendments referred to follow:)

AMENDMENTS TO H. R. 4473 PROPOSED BY REFRIGERATION EQUIPMENT MANUFACTURERS ASSOCIATION

1. Proposed new section between present sections 482 and 483, as follows:

"Section 3405 (b) is hereby amended by changing the period at the end of the second sentence thereof (after the word "units") to a semicolon, and adding "or to a bona fide wholesaler or jobber for resale by him to such a manufacturer or producer, if such refrigerator components are or have been in due course so resold"; and by adding in the following sentence, before the word "vendee" (wherever it appears) the word "ultimate."

Note: The second and third sentences of section 3405 (b) will then read as follows:

"Under regulations prescribed by the Secretary, the tax under this subsection shall not apply in the case of sales of any such refrigerator components by the manufacturer, producer, or importer to a manufacturer or producer of refrigerators, refrigerating or cooling apparatus, or quick-freeze units; or to a bona fide wholesaler or jobber for resale by him to such a manufacturer or producer, if such refrigerator components are or have been in due course so resold. If any such refrigerator components are resold by such ultimate vendee otherwise than on or in connection with, or with the sale of, complete refrigerators, refrigerating or cooling apparatus, or quick-freeze units, manufactured or produced by such ultimate vendee, then for the purposes of this section the ultimate vendee shall be considered the manufacturer or producer of the refrigerator components so resold."

2. Section 3405 (b) is hereby amended by adding at the end thereof the following:

"Under regulations prescribed by the Secretary, the tax under this subsection shall not apply to the exchange of used refrigerator components for other refrigerator components of the same type rebuilt wholly or substantially from used parts, whether or not an additional amount of cash is paid in connection with the exchange."

Senator MARTIN. Mr. Chairman, before you conclude these hearings, in order to save time, I would like to place in the record a statement of G. Mason Owlett, executive vice president and general counsel of the Pennsylvania Manufacturers Association and Casualty Insurance Co.

Senator MILLIKIN. It will be entered in the record.

(The statement referred to follows:)

STATEMENT OF G. MASON OWLETT, PENNSYLVANIA MANUFACTURERS ASSOCIATION AND CASUALTY INSURANCE CO.

On July 19, 1951, O. Glenn Saxon, professor of economics at Yale University, appeared before the Senate Finance Committee on behalf of the National Tax Equality Association and recommended changes in sections 204 and 207 of the Internal Revenue Code, the effect of which would make taxable as income to participating stock and mutual insurance companies, dividends paid to policyholders.

His argument in favor of the recommended changes was twofold. First, that stock, fire, and casualty insurance companies are placed in a disadvantageous competitive position because mutual and participating stock, fire, and casualty insurance companies are permitted to deduct from gross income dividends paid to policyholders, and second, that the elimination of this deduction from sections 204 and 207 of the Internal Revenue Code would produce considerable revenue to the Federal Government.

His argument is directed almost entirely against the mutuals which are taxed under section 207, but in order to be consistent, recommended that similar amendments be made in section 204 under which stock, fire, and casualty companies, such as ours, are taxed.

The arguments presented are patently fallacious. The proposal made on behalf of the National Tax Equality Association is a thinly veiled effort by the old-line stock companies to retain profits for the benefit of their shareholders and yet wipe out the competitive advantage held by those companies which do not retain profits for shareholders. It may as well be argued that one merchant who sells his goods at a lesser price than his competitor should be required to pay a tax on the profit which he would have realized had he sold his goods at the same price as the competitor.

It is also doubtful whether the proposed amendment would result in any substantial increase in revenue because the companies affected by the proposed amendment could, except in the case of workmen's compensation premiums, reduce rates to reflect the anticipated dividends to policyholders.

As stated by Mr. Saxon, taxation should be "measured by net profits." A return of unused premium to a policyholder, either by virtue of the terms of the contract of insurance or by the bylaws of the corporation, cannot under any circumstances be considered net profits to the corporation. Mr. Saxon does not attempt in any way to dispute this fact which is the basic issue.

The adoption of the amendment proposed to section 204 would have far-reaching consequences upon our companies and their policyholders. We understand that no further witnesses will be heard before the Senate Finance Committee unless a member of the committee so requests. If the National Tax Equality Association's proposal is to be given any serious consideration by the committee, we would like an opportunity for a spokesman of the participating stock companies to appear before the committee in the near future.

Senator MILLIKIN. As this point numerous statements and letters will be inserted in the record for the consideration of the committee.

RETAIL TOBACCO DEALERS OF AMERICA, INC.,
New York, N. Y., August 3, 1951.

Protest against any increase in excise taxes on cigars.

To the Members of the Senate Finance Committee:

The Retail Tobacco Dealers of America, Inc. is a national association of retail tobacconists, having thousands of members located in practically every large city in the United States.

About 1 year ago we appeared before the House Ways and Means Committee urging consideration of the proposal for reduction in excise taxes on cigars.

As a result of the facts presented by the cigar manufacturers which were heartily endorsed by us, the committee favorably recommended a reduction in these taxes.

The events in Korea, rapidly followed by the Government's decision to rearm, necessitated a complete reconsideration of the entire tax program.

However, the cigar industry never anticipated a further increase in existing excise taxes, since it was still struggling under the burden of the last war emergency tax increase.

May we point out for your earnest consideration—

1. Government figures over the past years have shown a setady decline in the consumption of cigars: 1920, 8,096,758,603; 1930, 5,889,132,434; 1950, 5,538,152,400.

2. Census figures prove that our population has steadily increased and with it we have the largest national income ever recorded.

The decline in consumption of cigars assumes even more serious proportions when compared with the increase in population and what should normally prove an increase in the potential cigar market.

3. From the retail standpoint, cigar sales constitute a most important part of the volume of our businesses, and we are dependent on the sale of this product for a profit which will enable us to continue in business. We know the consumer's reaction and we are certain that we will never be able to keep our present customers, let alone secure new ones, if this committee recommends any increase in the present excise taxes, which must be reflected in higher prices for the product.

4. Might we state that the cigar manufacturers have faced tremendous increases in the cost of leaf and labor, which in most cases they have absorbed, realizing that consumer resentment to any further increase in price of their product would be ruinous. Our industry, saddled with exceptionally high excise taxes, cannot produce cigars at a price which will encourage the youth of the Nation to smoke them.

We feel sure that the figures and facts prove that higher excise-tax rates in the long run will produce a decrease in revenue rather than an increase because of consumer resistance to higher cigar prices, and the Treasury Department will be defeating its own purpose.

Concurrent with this decrease in revenue to the Government will be the hardships worked on all branches of our trade. from the leaf farmer to the retailer who will watch their business dwindle year by year under the impact of a disproportionate tax load.

The cigar industry is cognizant of its own responsibilities in the matter of encouraging consumer demand and building volume. A tremendous promotional and advertising effort has been undertaken in recent years to encourage cigar smoking. Every branch of the trade is doing its share to stimulate the business. All promotional efforts will be unavailing if the Government saddles our trade with additional cigar excise taxes.

RETAIL TOBACCO DEALERS OF AMERICA, INC.,
By ERIC CALAMIA, *Managing Director.*

THE LANCASTER LEAF TOBACCO BOARD OF TRADE,
Lancaster, Pa., August 3, 1951.

Re Opposition to increase in excise tax on cigars.

SENATE FINANCE COMMITTEE,
Washington, D. C.:

The Lancaster Leaf Tobacco Board of Trade, located in Lancaster, Pa., is composed of all the leaf packers and dealers in Pennsylvania cigar leaf tobacco in Lancaster County, Pa. Collectively, we sell in excess of 60,000,000 pounds of this type of tobacco annually. Our warehouses are located in the vicinity of the farms where the tobacco is grown and we prepare this tobacco for market to the cigar manufacturer. We are entirely dependent upon the cigar industry for our livelihood and we are greatly concerned at the present downward trend in cigar consumption. We are firmly of the opinion that a contributing cause in the inability of the cigar industry to adjust to a peacetime economy is the great tax burden upon it.

Accordingly, we join in the protest of the industry in opposing any increase in cigar taxes and respectfully urge that you reject in its entirety the proposed schedule of the Secretary of the Treasury for an increase in cigar taxes.

Respectfully yours,

LANCASTER LEAF TOBACCO BOARD OF TRADE,
B. E. MANN, *President.*

STATEMENT OF MARK HESS, MANAGING DIRECTOR, PENNSYLVANIA TOBACCO GROWERS ASSOCIATION

Lancaster County, Pa., grows more cigar leaf tobacco than any other county in the United States. The Pennsylvania Tobacco Growers Association represents almost all of the growers of cigar leaf tobacco in the Lancaster area where all of the cigar-filler tobacco in Pennsylvania is grown. There are more than 2,500 growers in this area. The continued welfare of these growers is obviously dependent upon the prosperity of cigar manufacturers in the United States.

We were very much distrubed by the original proposal of Secretary Snyder who requested a $25 million increase in excise taxes on cigars when he testified before the Ways and Means Committee earlier this year. We were even more disturbed when following the refusal of the Ways and Means Committee to accept his recommendation, he appeared before the Senate Finance Committee and repeated his request for a $25 million increase in cigar excise taxes. We believe that the cigar industry would suffer gravely if such a tax increase were actually imposed.

It should be noted that the Secretary of Agriculture, last year, called for marketing quotas on Pennsylvania cigar leaf tobacco because he found that the supply of tobacco was tending to exceed the demand. This cooperative acted as agent for the Commodity Credit Corporation in making price-support loans on cigar leaf tobacco in Pennsylvania this year. This is the first year in which such a loan program has been undertaken. Some evidence of the extent to which supply now exceeds demand can be found in the fact that by June of this year we had made loans on more than 2½ million pounds of tobacco. This is about 5 percent of the Pennsylvania crop. In no previous year has so much tobacco failed to go directly into the warehouses of cigar manufacturers.

We feel that the above facts are clear evidence of the weakened position in which the cigar industry finds itself. Therefore we respectively urge that the Senate Finance Committee reject Secretary Snyder's proposal to increase the excise tax on cigars just as the House Ways and Means Committee did earlier this year.

STATEMENT OF JAMES LOVE, IN BEHALF OF FLORIDA AND GEORGIA CIGAR LEAF TOBACCO ASSOCIATION

The growers of cigar wrapper tobacco in the States of Florida and Georgia produce one of the most valuable cigar crops grown in the United States. The Florida and Georgia Cigar Leaf Tobacco Association represents almost all of the growers of this type of tobacco and is comprised of over 250 farmers.

It is our opinion that the proposal of the Secretary of the Treasury to increase the tax on cigars would have very disastrous economic effects upon us. All the evidence available indicates that the consumer is extremely reluctant to pay any more than he is now paying for his cigars.

If the cigar industry is forced to raise its prices as a result of the tax increase, there is only one place from which this tax increase can come, and that is, from the suppliers of the raw materials.

We feel, therefore, that our own welfare will be seriously jeopardized unless the Senate Finance Committee rejects the proposal of the Secretary of the Treasury.

THE SHADE TOBACCO GROWERS
AGRICULTURAL ASSOCIATION, INC.,
Hartford, Conn., August 3, 1951.

Senate Finance Committee:

The Shade Tobacco Growers Agricultural Association, Inc., is an association of tobacco farmers who grow shade-grown cigar wrapper tobacco in the Connecticut Valley. We represent the most valuable crop of cigar leaf tobacco grown in the United States.

Connecticut Valley shade growers are aware of the fact that the cigar industry has been suffering under the yoke of heavy excise taxes, and we are greatly concerned with the continued downward trend in the consumption of cigars. Our livelihood as farmers and that of thousands of workers whom we employ, is dependent entirely upon the cigar industry and any further recession in cigar sales will have its ultimate adverse effect upon us

Excessive taxation is a serious deterrent to healthy business and the imposition of increased excise taxes on cigars will be disastrous to the entire industry.

Therefore, we respectfully urge that you reject the proposal of the Secretary of the Treasury for an increase in cigar excise taxes.

Respectfully,

THE SHADE TOBACCO GROWERS AGRICULTURAL ASSOCIATION, INC.,
NELSON A. SHEPARD, *President.*

THE LEAF TOBACCO BOARD OF
TRADE OF THE CITY OF NEW YORK,
August 3, 1951.

Re protest against increase in excise taxes on cigars.

SENATE FINANCE COMMITTEE,
Washington, D. C.:

The New York Leaf Tobacco Board of Trade is composed of dealers in all types of cigar-leaf tobaccos. Collectively we sell a major portion of all tobacco used by independent cigar manufacturers, particularly the smaller ones. Our warehouses are located in the vicinity of the farms where the tobacco is grown and in many instances we prepare this tobacco for market to the cigar manufacturers, employing a large number of local workers. We are entirely dependent upon the cigar industry for our livelihood and we are greatly concerned with the present downward trend in cigar consumption.

We believe that a major cause of the cigar industry's inability to prevent a further decline in cigar sales has been the undue tax burden which it has borne these many years.

Therefore, we respectfully pray that your committee vote against the imposition of any increase in excise taxes on cigars.

Respectfully yours,

THE LEAF TOBACCO BOARD OF
TRADE OF THE CITY OF NEW YORK,
By JOHN A. REGAN, *Secretary.*

NEW YORK, N. Y., *August 7, 1951.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building:

Book publishers are deeply concerned by the proposal in the pending revenue act that 20 percent of the total literary royalties paid by publishers to authors be withheld at source. Book publishers earnestly and respectfully suggest consideration of the recommendations contained in the July 23, 1951, letter of Oscar Hammerstein II, president, Authors League, on behalf of all authors, including authors of books, in which he pointed out the great hardship which would, in very many instances, be imposed on authors whose total incomes do not justify the proposed withholding.

JOHN O'CONNOR,
President, American Book Publishers Council.

AMERICAN LIFE CONVENTION,
LIFE INSURANCE ASSOCIATION OF AMERICA,
New York 22, N. Y., August 7, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: Recent rulings issued by the Bureau of Internal Revenue have, in thir practical effect, destroyed the pension rights of a great number of insurance agents who are presently under pension plans of long standing; there is an urgent need for amending legislation to correct the inequities resulting from these rulings.

The enclosed memorandum more fully develops the hardships created by the rulings and also contains our suggestion for corrective legislation. We are authorized to say that the National Association of Life Underwriters joins us in strongly urging the adoption of the proposed amendment.

Yours sincerely,

AMERICAN LIFE CONVENTION,
ROBERT L. HOGG,
Executive Vice President and General Counsel.
LIFE INSURANCE ASSOCIATION OF AMERICA,
EUGENE M. THORÉ, *General Counsel.*

LIFE-INSURANCE AGENTS' PENSIONS—NEED FOR PROPOSED AMENDMENT TO SECTIONS 165 AND 22 (B) (2) (B)

The pension benefits of thousands of ordinary-life-insurance agents are in jeopardy as a result of rulings of the Commissioner of Internal Revenue. Under these rulings the aggregate contributions of the life-insurance company to the agent's pension fund would be taxed as income in the year in which the agent retires.

Under sections 165 and 22 (b) (2) (B) employee retirement payments are taxed to the recipient as they are received. The Commissioner contends, however, that these sections do not apply because life-insurance agents are not employees. These life-insurance agents' retirement plans meet all of the other requirements of these sections.

While most ordinary-life-insurance agents are independent contractors, they are a class of individuals who have many characteristics similar to employees. This was recognized by the Congress last year when the employee definition under the Social Security Act was amended to include the full-time life-insurance salesman.

The following actual cases illustrates the hardship these rulings have created:

A life-insurance agent retired on September 30, 1950, and was entitled to a monthly retirement benefit of $68.11, payable for life. The lump-sum value of this pension, $8,128.27, was contributed entirely by the life-insurance company over a period of years beginning with the establishment of the plan in 1942. It was assumed by the company and its agents that these pension payments would be taxed to the retired agent as received. Under the Commissioner's rulings, however, the entire value of the pension, $8,128.27, is taxable as income received during the year 1950. In this case, the resulting income tax of approximately

$2,000 would confiscate the agent's pension benefits for the first 2½ years of his retirement, or a part of his savings if he did not live that long, thus defeating the purpose of the plan.

THE PROPOSED AMENDMENT SHOULD BE ADOPTED FOR THE FOLLOWING REASONS

1. Unless legislative relief is granted; life-insurance agents' pension plans will not be able to serve the purpose for which they were created; therefore, it will be necessary to discontinue them. This result would be socially undesirable. It would be most unfortunate if plans adopted years ago to provide for such a worthy need should now fail because the technicalities of the law prevent carrying out the purpose for which they were adopted.

2. There is no fundamental reason why life-insurance agents who occupy a status similar to common-law employees should have their pension benefits dissipated by a tax on the value thereof in the year of retirement.

3. Employee pension benefits are taxed as they are received by the retired individual. Under the proposed amendment the life-insurance agent would be treated in the same manner. It is not proposed that retirement benefits payable to a life-insurance agent should escape taxation.

4. Life-insurance agents are now covered for old-age and survivorship social-security benefits. The life-insurance companies pay the employer social-security taxes on their earnings. When agents retire they are entitled to receive the same social-security benefits as common-law employees. To be consistent their pension benefits, if otherwise qualified under section 165, should be taxed like similar benefits paid to common-law employees.

5. No sound tax purpose would seem to be accomplished by laying such a confiscatory income tax on the value of these agents' retirement plan. The tax revenue involved is not significant. The Commissioner, in ruling on these cases, has informally expressed the opinion that he lacks the authority to correct this injustice. The amendment proposed will accomplish that result.

A BILL To amend the Internal Revenue Code relating to employees' trusts

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 165 of the Internal Revenue Code (relating to employees' trusts) is hereby amended by adding thereto a new subparagraph (e) to read as follows:

"(e) For the purposes of this section and of sections 22 (b) (2) (B) and 23 (p), the term 'employee' shall include a life-insurance salesman who is within the definition of an employee under the provisions of section 1426 of this code. This amendment shall be applicable with respect to taxable years beginning after December 31, 1938."

United States Senate,
Committee on Interior and Insular Affairs,
Washington, D. C., August 6, 1951.

Senate Office Bulding, Washington, D. C.

Dear Walter: I am submitting herewith the text of the presentation I had intended to make personally before your committee in support of my proposed amendment to the tax bill, H. R. 4473, to have trona included as a strategic mineral under the excess profits sections of the Internal Revenue code.

It is my understanding that this statement will be included in the transscript of the hearings as though presented, and I will appreciate it if you can see that this is done.

With every good wish, I am

Sincerely yours

Joseph C. O'Mahoney, *Chairman.*

Statement of Hon. Joseph C. O'Mahoney

Mr. Chairman and members of the committee, on August 2, on behalf of my colleague, Senator Hunt, and myself, I proposed from the floor of the Senate an amendment to the 1951 tax bill, H. R. 4473, by which the mineral trona would be included as a strategic and critical mineral under the provisions of the excess-profits tax law. Specifically, I proposed that a new section be added to title V of H. R. 4473, as follows:

On page 152, after line 7, add a new section, as follows:

"Sec.—. DEFINITION OF STRATEGIC MINERALS—(a) Inclusion of trona as a strategic mineral in the Excess Profits Tax Act of 1950:

"(1) Paragraph (1) (b) of section 450 of the Excess Profits Tax Act of 1950 (relating to the definition of strategic minerals) is hereby amended by inserting the word "trona" after the word "quartz crystals."

"(b) Effective date.

"The amendment made by this subsection (a) shall be applicable only with respect to taxable years ending after December 31, 1950."

The members of the committee will recall that when the excess-profits tax bill, H. R. 9827, Eighty-first Congress, was before the Senate last winter, I proposed an amendment to that bill from the floor to have trona included in the definition of strategic and critical minerals. The Senate accepted this amendment. The Senate and House conferees, unfortunately, did not follow the Senate, and trona was dropped from the bill in conference. I am very reliably informed that the dropping of trona was without prejudice, and was in no way a reflection upon the merits of the proposal, but rather was the result of insufficient information as to what trona is and its basic importance to our security and economy.

It is my intention at this time to give the committee further information.

WHAT IS TRONA?

Trona is the ore of a natural soda ash of virtually commercial purity in its natural state. The largest known deposits in the world are near Green River, Wyo., and the reserves there are in reality tremendous, possibly totaling, according to the estimate of reliable engineers, 7 billion tons. The deposit is found at 1,500 feet, and the bed ranges from 15 to 20 feet in thickness, extending over a known area of more than 40 miles.

Perhaps at this point I should state another very significant fact, namely, that in close proximity to this truly great deposit of natural soda ash are immense reserves of natural gas and coal. Thus the fundamentals for economic development, the importance of which is looming large in national-defense planning, is to be found in this area.

USES AND IMPORTANCE OF TRONA

When we speak of trona, we speak of natural soda ash—soda ash which can be produced at one-half the investment in plant per ton produced in comparison with the synthetic or ammonia soda method. In these times of critical shortages of steel, machinery, and other materials, the committee will give especial consideration to this fact, I know; namely, that it takes only one-half as much steel, for example, to produce a ton of soda ash from trona as it takes a produce a like amount by synthetic or manufacturing methods.

The basic importance and widespread use of soda ash is emphasized by the fact that more than 5 million tons are now produced annually in the United States. It is essential for the production of aluminum metal, a quarter-pound of soda ash being required for every pound of aluminum metal; for the manufacture of glass; and for the processing of metallurgical ores, among other basic uses.

For example, the processing of uranium ores in Colorado is dependent on uninterrupted supplies of soda ash which are now coming from the Wyoming deposit. Soda ash currently is being produced on a small scale at Green River. This operation is being carried at a loss, however, because of the lack of its small-scale basis.

Other basic industrial uses of soda ash are glass, which takes about 30 percent of current production, or almost 2 million tons annually; oil refining; wool scouring; rubber; printing inks; boiler compounds; paints; ceramics; enamels; and the like.

Of great potential importance also is its use in high-grade concentrated fertilizer. On this subject, the Bureau of Mines—since the production of soda ash from trona is basically a mining enterprise—has made several favorable reports.

Fertilizer based on Wyoming trona processed with phosphate rock contains both ammonia and nitrate nitrogen, and is subject to a considerable variation of constituents to meet the requirements of different soils and different crops. Its concentration is so great that it can be shipped economically to all parts of the United States, but it would of course be of especial importance to western agriculture.

The development of the Wyoming trona deposits offers tremendous opportunities for the development of agriculture in the Rocky Mountain and Northern and Southwestern States, as well as providing a basic industrial chemical for the growing aluminum and other defense industries in the area.

ADVANTAGES OF TRONA

The advantages of trona, or natural soda ash, over the manufactured product, or over such substitutes as caustic soda, are threefold:

(1) Economy in the use of scarce materials;
(2) The strategic geographic location of huge deposit;
(3) Lower cost of the finished product.

I would like to discuss these three national advantages in brief detail:

Soda ash from trona is economical in scarce materials

Production of soda ash from trona requires less materials and manpower than conventional methods. In view of widespread shortages of all materials for industrial construction, the fact that it is possible to produce soda ash from trona in plants costing less than one-half of the more conventional types of plants in terms of steel and building materials makes trona of prime importance to the rearmament effort. Since there is expected to be an ever-increasing shortage of soda ash in the next several years throughout the United States and particularly in the Western States, it is important that expansion of the soda ash industry be carried out by the cheapest methods in terms of critical materials and manpower. Development of the trona deposits offers the only way in which materials and manpower can be saved in this program.

Strategic location

The immense reserves of trona are found in the heart of the Rocky Mountain region—an area considered safe, relatively speaking, from probable enemy attack. It will serve the new aluminum plants in the Northwest as well as insure a continuous supply of soda ash from the processing of uranium ores in Colorado and elsewhere in the West. As I pointed out previously, a quarter of a pound of soda ash is required for each pound of aluminum metal. Development of trona deposits also will serve a great variety of other industries, present and planned, in the Rocky Mountains and Northwest.

At present, there is no production of soda ash of any significance in the Rocky Mountain-Northwest area. The area is suffering from a shortage of soda ash here and now. In fact, it is not too much to say that the industrial development of the West is being delayed by the lack of this basic industrial chemical.

The importance to western agriculture of large supplies of locally produced soda ash as a base for an extremely high-grade fertilizer, capable of great flexibility, as it were, in its constituents to meet varying crop needs, is self-evident.

Because it is produced from a natural deposit in the area, most of the finished product necessarily will be cheaper than products which have to be hauled considerable distance from eastern and midwestern centers of production. Equally important, since soda ash is now in short supply, the only possible substitute to supply the growing demand is caustic soda. Caustic soda is nearly twice as costly, per unit of contained alkali, as is soda ash. The following brief table illustrates this point:

Current market price Na_2O per net ton at works

Form:	*Value*
In light ash	$41.40
In heavy ash	44.80
In liquid caustic in tank cars	67.30
In solid caustic in 700-pound net weight drums	88.40
Flake caustic in 400-pound net weight drums	98.80

It should be noted that transportation of caustic requires either steel tank cars or steel drums. And steel in both of these forms is gravely needed by petroleum and other industries.

Transportation of soda ash from trona, on the other hand, can be had in wooden boxcars or trucks.

As a supplement to my statements with respect to shortages and costs, I would like to introduce into record by reference an article appearing in the technical journal, Chemical Week, for June 30, 1951. This industry observer finds serious shortages of soda ash probable within 2 or 3 years, and as a result foresees shap price increases, possibly double those currently prevailing.

Failure to include trona as a strategic mineral is a deterrent to the establishment of a chemical industry in the West.

The mining and processing of trona requires large amounts of capital which industry is reluctant to invest now under the present tax structure. Inclusion of trona as a strategic mineral in section 450 of the excess-profits-tax law will stimulate the development of trona in the same way such treatment helps the minerals now listed in the excess-profits tax law. Since soda ash is required for processing many of the listed minerals, a number of which are mined in the West, this action will also aid in increasing production of other strategic minerals.

At least one company is prepared to spend $15,000,000 in developing the Wyoming trona deposit. Such an investment would add at least 300,000 tons yearly to our soda ash supplies, and even this is capable of great expansion.

I earnestly urge favorable action by you gentlemen on amendment C of August 2 to H. R. 4473 and the inclusion of this basic chemical, produced from a great natural deposit in a safe area, in that section of the law providing for the stimulation of production of strategic minerals.

[H. R. 4473, 82d Cong., 1st sess.]

AMENDMENT Intended to be proposed by Mr. O'MAHONEY to the bill (H. R. 4473) to provide revenue, and for other purposes, viz: On page 152, after line 7, add a new section as follows:

"SEC.—DEFINITION OF STRATEGIC MINERALS.—(a) Inclusion of trona as a strategic mineral in the Excess Profits Tax Act of 1950.

"(1) Paragraph (1) (b) of section 450 of the Excess Profits Tax Act of 1950 (relating to the definition of strategic minerals) is hereby amended by inserting the word "trona" after the words "quartz crystals,".

"(b) Effective date.

"The amendment made by this subsection (a) shall be applicable only with respect to taxable years ending after December 31, 1950."

KALAMAZOO, MICH., *August 4, 1951.*

UNITED STATES SENATE FINANCE COMMITTEE, AND MEMBERS OF CONGRESS,
Washington, D. C.

GENTLEMEN: In accordance with the wire received from Elizabeth B. Springer, clerk of the Senate Finance Committee, I was informed your schedule of witnesses are filled, but I wish to thank you, Mr. George, for the opportunity of submitting my letter for the record of the hearing.

For me to be able to give you a full understanding of my views in a brief statement, it is impossible, as the economic structure of our great nation has become so complicated through the years by the repetition of tax bill after tax bill being added to more tax bills that I don't believe there is a living person that could name one-tenth of them—Federal, State, local and private—and I cannot put such an important thing as this in a brief letter.

The past 19 years I have been an ardent student of our economic structure from every angle, knowing that the day is at hand for the government of all nations to collapse and if you are a student of the Pyramids, you no doubt know that their prophecies are very clear and the government of this world will completely collapse by the year 1953 as we are living in the end of the Kings Chamber, besides the Pyramids we have the Bible of which is very clear on the rise and fall of the nations and when one is a real-born-again student of these two great God-given documents they don't need hesitate as to what lies before the nations today. I believe you can see it would be impossible for me to make these things plain in a letter.

In 1932 when the world was up against a stone wall, as it were, I said, "If there was any solution to our problem, it was in the Bible, and the only way anyone could find it was in God's own way, to fast for understanding." On March 10, 1932, I went on a fast for this understanding, and at the end of 10 days was given the understanding I was after. Then I started to search for figures to prove my point, so I could convince the Government of its merits. In November 1932 I went to Washington, D. C., for 4 weeks, and while there I talked with many Representatives, including the Speaker of the House, and I studied in the Library of Congress to get a thorough understanding of all the things I was interested in. Having gathered all the necessary information and statistics which I needed, I returned to Kalamazoo and started working on my charts, which I prove beyond all doubt that God's methods are the only way to solve our problems and stabilize our economy giving ample security to everyone in every walk of life from the cradle to the grave.

In September 1934, after the Supreme Court declared the NRA unconstitutional, I returned to Washington, with the hope of getting before a proper committee with this plan. I contacted Jasper J. Mayer, chief correspondent, about October 20. He got me to write my plan out briefly, as he told me he knew of no other way to get it under consideration. At that time Mr. Mayer told me I had the most complete set of figures ever brought to Washington by anyone, and that he knew every figure I had was authentic, but that he had never seen them applied as I had applied them. He also said if I would write the letter he knew he would O. K. it and that when he did there were dozens of people in the Government that would have to read it and either O. K. or object to it. Fifty percent O. K.'s would bring it before a committee.

October 22, 1934, I mailed copies of my letter to Mr. Mayer and to Lewis McHenry Howe, secretary to the President, and before the night of October 23 Mr. Howe wrote me that my letter had been brought to the President's attention. October 30 Mr. Mayer wrote me that it would be given every consideration of the administration, and on October 31 the United Press carried an article with the heading, "Weigh New Plan of Relief for Idle." And that was my plan.

Now I would like to show you a prophecy of the Pyramids of 5,000 years ago, which states October 1934 will start to mark the beginning of a new era, and from October 1934 to 1953 more will be accomplished along the economic lines than has been accomplished in the past 6,000 years, and before the year 2,000 has arrived the full establishment of the Kingdom of Christ will have taken place. That is the reason the Pyramid picture was placed on our dollar bill in 1935, showing this Nation is in that channel. I will defy the Government to show any plan other than the one I submitted that will coincide with the prophecies. There are many other prophecies which I would be able to show you, but I cannot find room in a letter to write them all out.

In November 1934 you should remember the 300 delegates and the brain trust that Mr. Roosevelt called in and placed my plan before them, but I had no chance to appear and debate my own views. Why? I know why.

Nevertheless the social-security bill was drafted off my plan, but all they did was a small fraction of what I offered. Therefore, its purpose was defeated, and many people were left paupers, and today we are head-over-heels in debt, with so many taxes placed on our backs that the mass of people can hardly exist, and more billions of taxes are being added, thus creating more and more inflation. Ninety percent of all inflation is created through Government tax policies under the disguise of stopping inflation. Had I been given a chance to appear before a proper committee in 1935 and had there been a proper bill drafted to accomplish all that God requires, we could have put the Government on a pay-as-you-go basis and not had one idle person from that day until now, with a pension for everyone unable to provide for themself, with ample purchasing power for everyone, and there would be only one single tax to replace all other taxes, and our Nation would have a flourishing economy and be free from debt today.

I pray that God can find enough Christian spirit within the hearts of the ones that read this letter to be able to move you to a place where you will have a thorough investigation of what God in His word requires us to do as a Nation before He has to pour any more of his judgments out upon our great Nation such as the great flood in Kansas, Missouri, and Oklahoma, which has at least cost these States a loss of a billion dollars to say nothing of what has been in other States, besides the untold other disasters in our land inflicted upon us by God, look at our war which is becoming world-wide with a terrible slaughter of human lives, to mention nothing of the billions of dollars of property destruction. Every one of these things are happening to our Nation simply because of our own national sins, and this can be corrected by Congress and Congress alone.

Now just sit back and figure up how much God has punished this Nation since October 22, 1934, through the present day, all because we don't humble ourselves before God to find out what He requires of us as a Christian Nation, as God never in the history of the world has ever brought war or calamity against His people at any time only when they were out of His will and disobedient.

In the past 16 years there has been thousands of years in man-days spent on hearings and drafting tax bills and social-security bills, all of which has only made millions of our people paupers and are grinding the face of all our people to the bone and bankrupting our Government while business is being brought to a standstill through such policies and now you again ask me to write another letter the same as when I asked to appear on your committee when you were having hearings on the expansion of the social security and I wrote you a letter then which was read before the Finance Committee in executive session and when they finished the session the committee voted to thoroughly investigate this plan and when you went before the Senate with the expansion bill the Senate passed a resolution demanding this plan be thoroughly investigated, and yet this never has been done. You may think I am very harsh in the way I write but there has never in the history of the world been a time when the people needed the guidance of God's word as it does in this day and hour.

In all my writing and appearances before committees and individuals in Government, I have never had one of you attempt to start an argument against what I offer. I feel it is high time for a proper committee to take my advice and thoroughly investigate what I offer before the atomic and hydrogen bombs start falling on us, because God is going to destroy two-thirds of the people of the nations and then try the rest; unless we humble ourselves and do His will we may get our share. Enclosed is a card for your benefit. I sent hundreds of them in to various Government groups following the war between Israel and the Arabians. At that time President Truman and Secretary Marshall jumped up one morning and wanted to stop the partition, thinking God would change His mind, but to this day He has not, but all nations are heading for war if we don't do something to straighten out this situation we are in.

Don't be fooled, God is going to completely crush all the world forms of government and rule in His own way of righteousness and He is going to establish it through the U. S. A. You can do a great deed by letting me have the necessary time to place before you God's requirements and save us from communism and untold destruction before it is too late.

For the past 19 years I have pleaded with various committees and divisions of Government to accept divine guidance to correct our economic structure and set before the world a system of economy that will give the world permanent peace and security for everyone, there is but one perfection that is God and His divine word, which includes His method of government, and the time for its adoption is at hand and there is but one way to find what it consists of, that is in God's own appointed way and by this method only can we ever stop Stalin and his communistic powers.

Since World War II there has been over $40 billion spent in an endeavor to correct the economy of Europe, whereas my contention is, if we correct our own economic structure and show them the merits of a true democracy where there is justice and ample security for everyone, they could adopt the same system and become self-supporting, the trouble is the money we send over there does not get into the pocket of the mass of the people so they can buy what they need.

President Truman once said "If the living standards of the people of the world could be raised 2 percent it would take years for industry to catch up with production." This I agree with, but the only way living standards can be raised is to put the purchasing power in the pockets of the masses of the people. If we would have adopted this plan in full detail in the year 1935 it would have raised the living standards of millions of our people by at least 50 percent and millions of others by more than 25 percent and everyone would have benefited more than we ever have, then other nations would have seen its merits and could have adopted the same method and communism would have been a thing of the past today.

There is a bill (H. R. 6453) before the House Ways and Means Committee known as the prosperity revenue bill introduced by Representative Plumley, which embeds the principles of this plan on the front cover of which I quote. "A bill to equalize taxes; to provide adequate social-security benefits for all American citizens; to solve both the wage problem and the pension problem to untax private enterprise and thus stimulate efficient production and full employment; to cut the hidden sales taxes out of prices and reduce the high cost of living; to provide incentive pay for Government employees to raise the efficiency and reduce the cost of Government; to collect enough revenue to balance the budget, retire the national debt, and in due course revalue the dollar; to make the tax rate automatically adjustable to stabilize our economy on a rising standard of living; and to correct the two basic faults of capitalism, remove the cause of socialization, and achieve honest and general economic freedom."

Every Member of Congress as well as the President and every economist knows as well as I do that in order to accomplish the establishment of a sound and permanent flourishing economy and a stable national income, it is absolutely necessary to take into our national planned economy every individual, as we are all a part of our economy and to obtain a perfect function we must understand in reality and practice the fundamental meaning of the statement over the doorway to the Justice Department, which states, "Equal justice under law" and this we haven't got, nor won't have until we have proper legislation by Congress that will give ample security to everyone and not just a few.

The present Social Security Act we now have does not give ample security to anyone so we have a repetition of relief agencies to supplement wherever it falls short.

This plan I have provides guaranteed employment, this method establishes ample purchasing power by perpetuating steady employment at all times for everyone able to work and an adequate pension for those unable to work, regardless of age, this would not require any relief agencies of any kind and these unfortunates would have a purchasing power as well as the fortunate ones. The present methods make such a repetition of agencies that the cost is so great it will eventually destroy our whole economy unless we correct it.

We now have several million unemployed and business is continuing on the downward trend. Why? Simply because the ones in our stable commodity industries are in a position today where they, through organized labor, have driven their earnings to such high levels they have forced the prices of most, if not all, commodities so high that the great mass of people are unable to pay the price. There are millions right now without purchasing power for anything other than just the bare necessities of life, and there are multiplied millions on incomes of less than $1,000 annually. This is far less than enough for even bare necessities, to say nothing about these people being able to purchase the stable commodities, which gives us a healthy economy.

I am 100 percent for ample security for everyone, from the cradle to the grave, and what I have to offer can easily be accomplished in a very short time and I am absolutely sure it is the only way to solve our economic problem.

To show you one man has always been used to speak, I will refer you to the past and I will show you too how this Nation can escape the wrath of God which is to be poured out upon the world in the near future without mercy.

There was Joseph, the slave in Egypt, 1707 B. C., Genesis: fortieth chapter and onward. If God had not raised him up, all mankind would have starved at that time.

Then came the deliverance of Israel from Egypt by Moses the sheepherder. Read the Book of Exodus.

Again when his people had fallen away from Him to worship Baal, God raised up Elijah and he straightened them out, but the nation was punished until they finally gave in and they listened to Elijah (1: Kings seventeenth and eighteenth chapters). This was 906 B. C.

Just think what a blessing those nations would have received had they taken these men before a proper committee and throughly investigated what they had to offer, before God had to pour out His punishing elements upon them.

Read the Book of Jonah, 862 B. C., when Jonah was sent to Nineveh, how God blessed them when they heard his warning and obeyed it.

We all know how Jesus pleaded with the Jews and they wouldn't listen and we know what has happened to them, as Jesus told them in Matthew, twenty-third chapter, thirty-seventh to thirty-ninth verses. He tells us the signs to watch for to be able to know when His day is at hand (Matthew, twenty-fourth chapter).

2 Chronicles, chapter 7, thirteenth and fourteenth verses states: "If I shut up heaven that there be no rain, or if I command the locusts to devour the land, or if I send pestilence among my people; if my people, which are called by my name, shall humble themselves, and pray, and seek my face, and turn from their wicked ways; then will I hear from Heaven, and will forgive their sin, and will heal their land."

In Malachi 3: 10 He states, "Prove me now wherewith saith the Lord of Hosts, if I will not open you the windows of Heaven and pour you out a blessing, that there will not be room enough to receive it."

In Malachi 3: 1 He states, "Behold, I will send my messenger and he shall prepare the way before Me"—showing specifically that one man is to show the way out of this crisis.

This Bible plan is His divine word and it contains full instruction for government regulation and He has always raised up a spokesman to show what was and is to be done.

In order to find out in full detail God's requirements, may I suggest that Congress appoint a subcommittee to work out a bill to accomplish all that is stated on the cover of H. R. 6453. In order to accomplish this task with proper details I believe this subcommittee should be composed of at least 8 Senators and 7 Members of the House and 1 member from each of the executive branches of Government, and at least 75 private citizens, to be appointed by various businesses on the basis of 1 being appointed by each line of enterprise.

In this way the subcommittee can be 100 percent nonpartisan and nonsectarian in scope. In order to finance this effort, I suggest Congress make the appropriation in the following order. Congress has just been asked for $8½ billion for defense and relief of Europe. May I suggest they appropriate this and allot $6 billion for defense of Europe and $2 billion for their relief and one-half billion for our own defense, this to be used for this subcommittee.

In order to get high-quality personnel I believe every one of these salaries should be set at $25,000 per year and if they complete the necessary methods to solve our problems and stabilize our economy as outlined on this bill in 1 year then give every one on the committee a bonus of $200,000 tax-free.

I feel that through my 10 years of work on this plan I am as qualified as any living person for one of these positions on this subcommittee, especially in view of the fact that I am the author of the plan; and the first thing the subcommittee should do is to let me place before them in full detail every angle of what I have to offer for the benefit of the committee. Then let them have a chance to debate it from every angle then draft a bill or bills necessary to establish our own national income on sound and practical business principles, giving ample security to everyone from the cradle to the grave, as outlined on the cover of H. R. 6453.

If Congress can see fit to carry out this suggestion in full detail and let us get started by September 1, 1951, I can assure you it can be possible to stop the spread of communism and end the war in a very short time and we never will need worry about another recession. Neither will we need finance other nations any more, as they can adopt this method and support themselves.

Hoping to be able to serve my country for the good of humanity as outlined.

Very truly yours,

FRED WHITMORE.

STATEMENT OF J. S. FINGER, PRESIDENT, CORRULUX CORP., HOUSTON, TEX., CHAIRMAN, YOUNG AMERICAN BUSINESS CONFERENCE

This statement is made by me as the authorized representative of a group comprising nearly a hundred successful postwar companies, and I address this committee not only on behalf of the corporation of which I am president, but on behalf of this entire group, the Young American Business Conference.

First let me define the Young American Business Conference. It is a group of companies formed after January 1, 1946, numbering 92 as of Monday of this week, and adding new participants at the rate of about 10 each week. This conference exists solely for one purpose—that of analyzing fully the impact of the present excess-profits-tax law on postwar business, and of bringing the facts of that analysis before this committee.

All the member companies in our conference, which are distributed geographically from Portland, Ore., to Macon, Ga., have three things in common. First, they were incorporated after January 1, 1946. Second, they are small companies, by the definition of 500 or less employees, or $5,000,000 or less in assets. Third, they face stagnation or extinction because of the excess-profits tax.

The members of this national group do not believe it was the intention of this committee or this Congress to create a discriminatory hardship for small new businesses. We are perfectly willing to pay our fair share of the tax burden, but we cannot maintain our present positions competitively nor fulfill our normal growth and expansion under the present and proposed tax structure.

In a report dated January 15, 1951, to the Senate, Senator Sparkman, chairman of the Senate Small Business Committee, stated as a result of his committee's hearings—

"It (the Excess Profits Tax Act) of necessity will bear more heavily on the young and growing businesses which have no historical profit base. * * * Furthermore, it is these really small enterprises which often need all their profits to plow back into the business to meet their capital requirements. Many studies have shown this reinvestment of profit to be the chief source of capital for small businesses and, as the basic tax rate rises, the amount of profits remaining after taxation will be proportionately reduced."

This conference has not rushed headlong into a position of opposing the present tax structure simply because its members are averse to paying taxes.

Careful studies have been made of the individual members' situations, and sound economic conclusions drawn both on the individual case histories and on the economics of the postwar section of business as a whole. Here are some of the conclusions which are inevitable and inescapable.

The present condition is a literal threat to the system of free enterprise and is definitely conducive of monopoly and of restriction of the development of any but old and established business firms. A published editorial in the Dallas Times-Herald thus expressed the question very succinctly: "Will this country continue to develop new businesses to meet new needs, or will established corporations take over new fields and new needs for increased productivity as they become apparent?"

Here are the specifics of the way the present tax law operates to the detriment of every successful business which has been incorporated after January 1, 1946.

1. There are insufficient funds left after taxes to plow back into necessary plant expansion and improvement.

2. There are insufficient funds left after taxes for the increased working-capital requirements in an expanding business.

3. The necessity of paying 50 percent of the tax by March 15 further decreases available working capital.

4. Small new businesses are forced to charge regular depreciation on plant and equipment and yet compete with older established companies who in many cases have already written off such equipment.

5. Small new businesses are forced to plow back every cent to fixed assets and increased inventories and therefore cannot accumulate any of the necessary reserves required to tide the business over a business-cycle bobble.

6. Small new businesses less than 5 years old are still considered risky by bankers and insurance companies, and therefore it is virtually impossible to obtain capital loans from these sources.

7. Small new businesses which have developed new products and processes but which are held down by high taxes to the extent that they cannot expand fast enough to meet the demand they have created and enjoy the business which they have rightfully earned, are being made a prey to the larger corporations who have the necessary funds to take advantage of the market which the little fellow has developed.

8. Of all the small corporations formed since 1946, only a few, perhaps 1,000, are advanced enough in their profit picture to be severely hurt by the excess-profits-tax law. Yet, under a less severe tax program these rapidly growing companies of today would be America's new industries of tomorrow. Through rapid growth they would actually furnish more revenue to the Government in 2 or 3 years. The loss of revenue to the Treasury this year and next year would be relatively small under our proposals (probably less than $50,000,000), yet we shall be encouraging competition, free enterprise, and American leadership and industry of tomorrow. This is certainly a small tax for the Treasury Department to defer.

9. None of the present methods of computing taxes takes into consideration that in most cases a manufacturer loses money during the first 12 to 18 months before he is able to break even and start making money.

10. The present law is a direct discrimination against veterans. Growth company relief being confined to companies incorporated prior to January 1, 1946, this arbitrarily rules out the thousands of American businessmen who were wearing uniforms on that date and whose postwar business efforts are thus arbitrarily and automatically subjected to the maximum confiscatory tax rate.

There was a time in American history when a man or a group of men could invent a new product or discover a better way of doing something and, through diligent work, good leadership, efficient management, and aggressive selling, they could build an industry. This is the history of the automobile industry, the aircraft industry, the appliance industry, and the chemical industry. Tomorrow's industries which will keep our productive capacity high and our employment full cannot be built under the ceiling of a 62-percent tax.

It is our conviction that the provision in the present law, which denies use of any growth formula to companies formed after an arbitrary date of January 1, 1946, is working an unintended hardship on new business. We do not think that Congress intended to lower an iron curtain on all expansion and industrial opportunity after a certain date. We know you gentlemen realize that there would inevitably be many businesses formed as a result of technological advances, new ideas, and new needs for more products in any period, without regard to military events, such as the Korean adventure. We can't brand all new corporations as "war babies" just because they came into existence after a certain arbitrary date some 4 years prior to Korea.

We submit that any taxation which imposes a higher rate on small new firms, because of their youth and lack of historical earnings experience, than is imposed on many large firms with plenty of surplus and capital investment, is an absolute monstrosity. Its inevitable effect is to limit the growth of all new businesses, and make it simple and easy for older, larger corporations to move in on the markets, simply because new companies cannot retain enough of their earnings to expand in step with the markets they have helped to create. This Government is pledged to the support and protection of "small business" but under this law all postwar business is virtually frozen at its 1950 level of expansion and capacity.

It seems needless to point out that the present law is direct discrimination against veterans. How could men who were in uniform on January 1, 1946, have started a postwar business in time to qualify for the present growth company relief formula? As one member of this conference has already said before your committee, "We were soldiering when, according to the excess profits tax law, we should have been incorporating."

The Young American Business Conference does not represent one selfish company which seeks to retain more of its earnings to put in its stockholders' pockets, nor a dozen such. It represents an entire sector of American industry—the pioneering and dynamic sector—the industrial leadership of tomorrow. We have made a survey of over 3,000 certified public accountants throughout the entire country. On the basis of this survey, we can tell you that there are not less than 2,000 small postwar companies in the same situation. This figure may run as high as 4,000, but 2,000 is an absolute minimum. These companies, their employees, stockholders, and members of the communities in which they play an important part as local employees, are looking to this Congress for the same opportunity to expand and grow that every other company in this country's history has had up to July 1, 1950. We propose certain relief provisions as amendments to the present excise profits tax law. These relief provisions will probably be an asset to the Treasury Department in that the net revenue over the next 5 years will actually be increased through capital reinvestment rather than decreased. This is due to the fact that most successful new businesses who are being hurt by the present excess-profits-tax law are growing very rapidly and some are probably earning as much as 50 percent per year on its reinvested capital before taxes. This high rate of earning is not due primarily to the war situation but rather to the normal rapid expansion of a new industry taking its place in the domestic economy. Therefore, every dollar of earnings which Congress allows us to plow back into our businesses this year will probably produce 50 cents of income next year, which in turn is taxed to the extent of 25 cents. Every dollar of investment taken away from us during this fast-growing stage means a minimum loss of 25 cents of revenue next year and succeeding years for the Treasury.

Obviously the cumulative result of reinvesting 20 percent of our income each year in a rapidly expanding business will continue to produce a high income subject to taxation, which will more than offset the "losses" which the Treasury Department might believe it is suffering if this relief is given us. Furthermore, tax relief for capital reinvestment is the type which does not go into someone's pocket but rather is the type that produces more jobs and income subject to taxation.

Therefore, it is highly essential that the Congress and the Treasury Department realize that they will not be taking a loss by granting this relief; but will actually be making the best possible type of investment: an investment which will yield 25 percent per year net profit to the Treasury and in addition produce a capital gain of the finest sort—a capital gain in America's future.

Attached hereto is a summary of the adjustments to this law which this conference submits would eliminate the inequities herein described.

AMENDMENT TO EXCESS-PROFITS LAW ENACTED IN 1950 IS SUGGESTED EMBODYING THE FOLLOWING PROVISIONS TO ELIMINATE DISCRIMINATION AGAINST NEW COMPANIES

QUALIFICATIONS FOR RELIEF

It is suggested that the terms of relief herein expressed be available only to corporations to whom the present growth company relief is now denied, i. e., corporations formed subsequent to January 1, 1946.

Total assets of such corporation must be less than $5,000,000 or total employees must be less than 500 persons at all times during the excess-profits-tax year. This limitation includes any and all persons defined as employees by FOAB tax legislation.

Assets defined as in sections 442–446: The sum of the cash and other property (other than inadmissible assets and loans to members of a controlled group as defined in sec. 435 (f) (4)), held by taxpayer at the end of such day in good faith for purposes of business. "Property" shall be included in an amount equal to its adjusted basis for determining gain upon sale or exchange, except that the adjusted basis for secret processes and formulas, good will, trade-marks, and other like property shall be determined without regard to value as of March 1, 1913.

RELIEF SOUGHT

A. Extension of "growth company" benefits now incorporated in the excess-profits-tax law to companies formed during 1946 who qualify under the present definition of "growth companies" in all respects other than date of incorporation.

B. Establishment of a base period within each qualified (incorporated after January 1, 1946) corporation's earnings experience. This base period would commence from the first day of each corporation's incorporation to a total of 48 months or less. During this period the corporation may use its highest 12 consecutive months as a base for computation of excess-profits-tax credit, providing that such portions of this base as may occur subsequent to 1950 shall be discounted at the rate by which the average of all corporate earnings during the current tax year exceed the average of all corporate earnings during the 48 months 1946 to 1949, inclusive. (This is expressive of the philosophy of the present law permitting some taxpayers to develop an average base period net income from experience in 1949 and 1950, discounting the 1950 income by 20 percent, Senate Finance Committee Rept. No. 2679, p. 27.) It is suggested that such discount in computing an average base period net income be limited to 20 percent as expressed in the present growth-company formula.

If such corporation has less than 12 months' experience prior to the excess-profits-tax year, it shall take its actual number of months divided into the income for the tax period and multiply by 12.

The corporation's average base period net income shall be deemed to have been established by the highest 12 consecutive months of its first 36 months of existence (with post-1950 discounts as indicated above) and shall remain fixed during the life of the excess profits tax law, provided, however, that corporations whose earnings during the last 2 years of the 48 months' base period are 50 percent above earnings in the first 2 years of the period, or whose gross sales are 30 percent increased in the last 2 years over the first 2 years, shall be permitted to calculate their average base period net income as the highest 12 consecutive months in the 48 months period, subject to adjustment as provided above.

Provided further, that during the first 8 years of a corporation's existence, the philosophy of the growth company formula apply to companies having growth characteristics of an increase in profit of 50 percent over the previous year or an increase in sales of 30 percent over the previous year, to the extent that, in computing tax for each excess profits tax year, they may use as their average base period net income their best 12 consecutive months including the first 6 months of the excess profits tax year.

C. In lieu of the 12 percent capital additions credit now provided during the current excess profits tax year, a 20 percent growth allowance should be granted for the first 5 years of such corporations' existence, expressed as tax exemption for capital additions and improvements up to 20 percent of the net taxable revenue for the tax year.

D. All taxation (normal, surtax and excess profits tax) on companies herein qualified, regardless of tax computation, to be limited to 52 percent of their net taxable income for five excess profits tax years or during the life of excess profits tax legislation, whichever is the shorter.

E. Amounts used to retire bank loans, debentures, or preferred stock obligations, contracted prior to July 1, 1950, and after January 1, 1946, in accordance with schedule of retirement set up at time loan was contracted shall be exempt from excess profits tax computations.

SPECIFIC CASE HISTORIES OF SMALL NEW GROWTH COMPANIES INCORPORATED AFTER JANUARY 1, 1946, RETARDED BY EXCESS PROFITS TAX

Company A, plastics manufacturing—Starting capital, $55,000

Incorporated 1948. Lost money 1949, first earnings 1950. Earnings rate doubled in 1951. Capital assets doubled in 1950. Now in maximum excess profits tax bracket; needs to reinvest at least $75,000 per year for 3 years in increased productive capacity to hold place in market.

Company C, vitrified pipe manufacturing—Starting capital, $500,000

Incorporated 1947, lost money first year, first earnings in 1948; 100 percent earnings increase in 1949, and again 100 percent in 1950. Capital investment increase 300 percent in 1948, 50 percent in 1949, 100 percent in 1950. Needs to reinvest minimum of $50,000 per year next 3 years in increased productive capacity. Company fully qualified as "growth company" if in existence in 1946; under growth formula, for a full year in 1950, taxes would have been $16,000 less in 1950.

Company C, vitrified pipe manufacturing.—Starting capital, $500,000

Started in 1947, lost money that year. First earnings 1948, increased 10 percent in 1949, increased 180 percent in 1950. Now in maximum bracket, needs $200,000 reinvestment to follow present expansion curve.

Company D, specialized steel pipe for geophysical exploration—Starting capital, $12,000

Started in 1946. Sales trebled in 1947, doubled in 1948, fell off in 1949, up 500 percent in 1950. Earnings up 90 percent in 1947, up 150 percent in 1948, net loss in 1949, up 500 percent (over 1948) in 1950. Needs $50,000 a year for next 5 years to increase productivity to hold market created by new product. Fully qualified as growth company in every way except age.

Company E, metal products—Starting capital, $120,000

Formed in 1949, loss first year of operation. Sales up 500 percent in 1950, first earnings in 1950. Orders for new equipment for expansion placed full 12 months in advance, now has expansion commitments which cannot be met under present law.

Company F, ceramic manufacturers—Starting capital, $100,000

Started in 1947. Earnings up 700 percent in 1948, down to 200 percent of first year in 1949, up 700 percent in 1950, projected increase of 100 percent in 1951. Now paying from 5 percent to 15 percent more taxes than direct competitors only 2 years older. This is the first year no substantial expansion has been made; competitors taking over markets. Net profit after taxes this year, under present law, will be the same as it was 3 years ago on capital investment of one-third present investment.

Company G, automotive equipment—Starting capital, $500,000

Started 1949. Earnings doubled in 1950, present rate up 120 percent over 1950. Under present law has only one-third the excess profits tax credit allowed older competitors with same assets, same sales, same approximate earnings rate. Unable to continue expansion program, or even to purchase building in which operation is housed.

BALLARD, SPAHR, ANDREWS & INGERSOLL,
Philadelphia, August 2, 1951.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate,
Senate Office Building, Washington, D.C.

Re Section 863 (c), Internal Revenue Code, Works of Art on Loan in United States.

MY DEAR SENATOR GEORGE: As president of the Philadelphia Museum of Art, I write to you on the above matter.

I have before me a copy of the letter which Mr. Redmond, as president of the New York Metropolitan Museum of Art addressed to you under date of July 27. Please accept this letter of mine as a wholehearted endorsement of Mr. Redmond's presentment.

You may have noticed the immense publicity in Life and in other national magazines with respect to the loan exhibitions of European art brought here during the past few years on the initiation of American museums. This publicity is indicative of the great cultural stimulus that the American public receives from such exhibitions.

As matters now stand, the Internal Revenue Code places upon any European a grave threat of taxation if he, following generous impulses, loans a masterpiece to one of our American museums. We certainly should not run the risk of taxing a resident European for pursuing a course so valuable to this country as lending to this country his masterpieces. The risk exists if the generous lender should die during the period of the loan. This condition makes it more and more difficult for the publicly supported museums of the United States to give to the public the inspiration and pleasure that comes from overseas loans. The situation would be entirely cured if Mr. Redmond's suggestion for the amendment of section 863 (c) was carried out, and I do trust you will give thoughtful consideration to his request.

Very truly yours,

R. STURGIS INGERSOLL,
President, Philadelphia Museum of Art.

THE NATIONAL WRITERS CLUB,
Denver, Colo., August 3, 1951.

The SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.

DEAR SIRS: The members of the National Writers Club urge you to reconsider the provision of title 2 of the Revenue Act of 1951, pertaining to the withholding of tax at the source on payments made by publishers of magazines, newspapers, and books. Sections 1220 and 1221, as I understand the proposed act, are especially unsatisfactory.

The National Writers Club, a nonprofit organization incorporated under the laws of the State of Colorado, represents more than 5,000 writers throughout the United States. The organization was founded 14 years ago in order to serve the best interests of the part-time, free-lance writer. We are probably more aware of the needs, problems, and difficulties of this group of writers than any other single source. Having given careful thought to the proposed act, we are convinced that its enactment into law would create an extreme hardship on a large group of citizens characterized solely by their special ability to write salable material.

We speak particularly for the professional and semiprofessional writers who supplement their earnings through their writing or who are just beginning to earn more than token amounts. Compensation received for manuscripts, especially by this class of writer, is usually far from commensurate with the amount of effort that goes into the writing of stories, articles, poems, and other material. Should payment in an amount equal to 20 percent be withheld at the source, these persons would thereby be taxed far out of proportion to the amounts levied on the returns from labor or creative efforts of other classes.

We can foretell an even more disastrous result from the act. The responsibility of magazines to keep records would react against the interests of thousands of new writers. Rather than face the burden of keeping records on payments to a large number of writers, it is entirely likely that many publications, especially the smaller ones which offer the best markets to new writers, would either depend upon staff employees or a limited group of regular contributors for their manuscript needs. This would result in a curtailment of opportunity that would not only affect a great number of individuals but would also have a limiting effect upon the literary output of America.

Many publications are short-lived. Free-lance writers even now experience frequently the difficulty of getting back manuscripts from defunct publications whose owners apparently have little conscience. If the new Revenue Act of 1951 is imposed, it is entirely likely that many of these publications, whose records appear to be insubstantial, will disappear along with any records of the 20 percent withheld from writers. Often these publications have no employees and therefore are not answerable to the Government on other provisions dealing with taxes relating to employees.

Apparently the intent of the sections of the proposed act is to insure inclusion of such income on income-tax reports made out by individuals. It appears that the necessity to observe the operations of hundreds of small publications and the cost of necessary forms and additional employees would more than wipe out any possible gain to the Government as a result of withholding 20 percent on the sale of literary material. This from the practical side. As a point of justice, the revenue act would place a penalty on the ambition and extravocational efforts of thousands of persons who would have to pay an abnormally high tax rate. The result may well be a stultification of creative literary effort at a time when encouragement is so sorely needed.

For the reasons stated in the foregoing paragraph, we respectfully urge that you spare the free-lance writers of America the difficulties and limitations which the proposed act would impose.

Sincerely yours,

DAVID RAFFELOCK, *President.*

STATEMENT OF R. J. WILKINSON, EXECUTIVE MANAGER OF THE MASTER PHOTO DEALERS' & FINISHERS' ASSOCIATION

Mr. Chairman and gentlemen, my name is R. J. Wilkinson. I am executive manager of the national trade organization in this field, the Master Photo Dealers' & Finishers' Association. This organization is composed of the retail photographic dealers and photo finishers who operate the commercial processing laboratories.

Knowing the pressure for time, under which you gentlemen are working and that our previous comprehensive statement is in your files, I am eliminating the volume of statistical facts and would focus your attention on a few major points which we feel should get full consideration in revising the legislation on photographic excise taxes.

PHOTOGRAPHIC TAX IS A TAX ON BUSINESS OPERATION

1. Despite a common opinion, photography is not a luxury by any measure. Industry statistics show conclusively that well over two-thirds of all equipment and materials produced and sold are for commercial, industrial, medical, reproduction, illustrative publishing and other business uses. All of these business uses are curtailed or burdened by the present provisions of the photographic excise tax law. Even in the so-called amateur end of the business a great portion of sales are made for semicommercial or illustrative photography.

TAXING TOOLS AND MATERIALS TO WORK WITH IS WRONG

2. The excess photographic excise tax that has been applied on machinery, equipment, and the tools to work with has worked a peculiar hardship on the photo finishers who are constantly required to add new machinery for processing as the industry becomes more mechanized. Taxing photographic processing equipment and the materials that these photo finishers work with is just the same as taxing the lathe that goes into a small machine shop or the cooking grill that goes into a restaurant. It's the tools they work with. Obviously such taxes should be eliminated and the correction is long overdue.

3. Contrary to general opinion, while the photographic excise taxes are manufacturers excise taxes—the retail photo dealer and photo finishers are the ones who are directly hurt. They are forced to prepay these excise taxes and put on their shelves thousands of dollars in a dead investment in "no profit" tax dollars upon which they can make no profit whatever. This results in a reduction of the

normal profit mark-ups which this business requires to make a decent return on investment. This situation stems from wartime decrees of OPA which prohibited making a mark-up profit in the handling of manufacturers' excise taxes. The result now is that with reduced sales volume coupled with the reduced mark-up which these wartime taxes thus imposed, many store are operating near the break-even point or with a loss.

PROPOSED ADJUSTMENT IN H. R. 4473

Members of the industry are of course aware of the revenue problems of the Congress that have been precipitated by the present state of international emergency. We recognize that in this situation any hope of complete elimination of the World War II excise taxes on photographic goods must be revised. We believe, however, that there is a definite obligation upon the Congress to adjust the long time existing inequities and particularly as they exist in imposing excise taxes on raw materials and processing tools to work with.

We have presented our views to and have worked with the House Ways and Means Committee to the end of adjusting the inequities while at the same time recognizing the revenue raising obligations resting upon Congress. The provisions of H. R. 4473 (sec. 485), as passed by the House, seems to us to represent a practical workable compromise approach to the imposition of excise taxes on photographic goods and equipment. We feel that the amendment in section 485 of H. R. 4473 expresses a taxing formula that should meet with the demands of reasonable persons in the photographic business and at the same time take note of the tax requirements of the present situation insofar as this segment of business is concerned.

In view of the corrections to the business cost items which this bill proposes, we are voicing no objecion to the taxes imposed but we do wish to point out that they amount to a rate of taxation that is still twice the manufacturers' excise taxes which have been imposed in the war and postwar years on other similar businesses. We recognize that nothing can be done now to further alleviate this tax burden but we urge that the record show that photography is and should be one of the first businesses to secure complete removal of excise taxes, if and when the emergency period has passed.

We respectfully recommend that the committee approve and pass to the Senate for approval the provisions for amendment of the photographic excise taxes as proposed in H. R. 4473.

Respectfully submitted.

THE AUTHORS LEAGUE OF AMERICA, INC.,
New York 16, N. Y., August 3, 1951.

To The SENATE FINANCE COMMITTEE,
Senate Finance Building, Washington 25, D. C.

DEAR SIRS: We of the Authors' League of America, Inc., submit this statement in support of an amendment to the proposed Revenue Act of 1951 introduced by the Honorable Irving M. Ives on July 25, 1951.

Throughout our more than 25 years of existence we have become familiar with all of the problems that confront authors, playwrights, and other creators of literary material. During this time, our most perplexing problem has been that of financial security for the individual self-employed author. As the committee well knows, the amount of yearly earnings of any one author is uncertain and subject to tremendous change from year to year. An author for example, might receive an income in excess of $35,000 for the year in which a work of his enjoyed popularity. The next 3 or 4 years might very well prove to be complete financial failures. Because of this unsteadiness of yearly earnings and unpredictability of the future, it would be to the great advantage of every author in the United States to have some plan whereby he could provide, in those few years of plenty, for the future when his income would be greatly diminished.

As we understand it, the amendment proposed by Senator Ives provides that an author, among others, may put a portion of his yearly income into a retirement fund and the tax on the income so set aside would be postponed until some later date when the income from the aforesaid retirement fund is utilized. Among the advantages to the author of this provision are the following:

1. Inasmuch as the earned income of an author for the year in which he is exceptionally successful is not a true reflection of his earning capacity, it is

unfair that he be placed in an income-tax bracket corresponding to the amount of income received for that year, without taking into consideration the unproductivity of past and future years. This provision would in part remedy this unfortunate situation in that the setting aside of a portion of the author's income into a restricted retirement fund would relieve him of some of the tax burden sustained for the exceptional year and apportion it more evenly among the years of feast and famine.

2. The proposed amendment gives to the self-employed author the benefits which an employee of a large corporation has in that the author will have his own pension plan, in much the same way as the employee enjoys the benefits received from a corporate pension plan. For many years, self-employed individuals have been at a disadvantage in this respect and the proposed legislation would now give them an opportunity to provide for their future.

In accordance with the views herein stated, we respectfully submit that the amendment of Senator Ives introduced on July 25, 1951, to the proposed Revenue Act of 1951 be adopted.

Respectfully,

OSCAR HAMMERSTEIN, 2d, *President.*

STATEMENT OF HON. CLAUDE I. BAKEWELL

Mr. Chairman, the St. Louis Symphony Orchestra is the second oldest symphonic organization in the country. It was founded more than 71 years ago. Now it is confronted with financial difficulties which make the continuance of the orchestra uncertain. Last year it operated at a deficit of $40,000. This is approximately the amount which the orchestra contributed to tax revenue of the United States as a result of the payment of the 20-percent Federal amusement tax.

The experience of the St. Louis Orchestra is typical of similar orchestras all over the country. Friends of symphony orchestras and opera associations throughout the country were heartened by the action of the House in passing a bill which would exempt such cultural, nonprofit groups from the present 20-percent amusement tax. In numerous instances this tax would impel the organizations to be discontinued. Certainly that is the case of the St. Louis Orchestra.

In the interest of our cultural heritage I most strongly urge, Mr. Chairman, that your committee adopt the bill which is in the committee providing for exemption from Federal tax nonprofit, cultural groups such as symphony societies and opera associations. I urge you, Mr. Chairman, and the mebers of this distinguished committee to retain that provision of the House bill.

A RESOLUTION

Resolved, That the proposal of the Senate Finance Committee to remove from tax exemption the sale of municipal bonds, thereby forcing upward the interest rates necessarily chargeable on such bonds, would wreak an unwarranted financial hardship on municipalties throughout the country: Therefore, be it further

Resolved, That the Business and Civic Association of the Tonawandas, Inc., hereby goes on record in direct opposition to the proposal so to remove the tax exemption of municipal bonds.

Adopted: Unanimously.

Date: July 19, 1951, regular monthly meeting.

By: Board of Directors, Business and Civic Association of the Tonawandas, Inc., Power Building, North Tonawanda, N. Y.

CHARLES A. SUCHAN,
Secretary to the Board.

LOS ANGELES CHAMBER OF COMMERCE,
August 3, 1951.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington 25, D. C.

DEAR SENATOR GEORGE: In connection with your consideration of the new tax bill, we are listing below the recommendations of the Los Angeles Chamber of Commerce:

SIZE OF TAX BILL

The amount of estimated new revenue produced under the House bill (H. R. 4473) should be taken as a maximum goal in the current tax program, and the budget should be brought into balance through reduction in expenditures in civilian and military items aggregating not less than $5.3 billions.

INDIVIDUAL INCOME TAXES

(*a*) Proposals for increases in individual taxes measured by a flat percentage of the present tax should not be adopted; but additional levies, if made, should be in the form of increases in the individual tax brackets.

(*b*) If additional income taxes are levied, recognition should be given to the fact that tax legislation for almost two decades has been passed upon a "soak the rich" philosophy, with the result that rates in the middle and upper income brackets already are so high as to constitute a positive deterrence to personal initiative and the development of the productive capacity of America.

CORPORATE TAXATION

(*a*) There should be no further increase in corporate excess profits taxes.

(*b*) The ceiling rate upon corporations should in no event be raised beyond the present indefensibly high 62 percent.

EXCISE TAXES

To the extent that the budget for fiscal 1952 remains unbalanced after giving effect to the above recommendation, the difference should be made up through the imposition of a manufacturers' excise tax of general applicability.

These recommendations were formulated after careful study by our Federal affairs committee and are as approved by the board of directors at its meeting August 2, 1951.

Since we were not personally represented at your hearings, we would appreciate your incorporating this letter in the hearing record.

Sincerely,

HAROLD W. WRIGHT, *General Manager.*

Suggested changes to be made in the Revenue Act of 1951, H. R. 4473, submitted by John E. McClure, McClure & Updike, Washington, D. C.:

1. Section 313 pertaining to family partnerships should be made retroactive.
2. S. 942, a bill to provide for the abatement of tax for certain trusts, the income and corpus of which are equitably owned by members of the Armed Forces who died on or after December 7, 1941, while in active service as a member of the military or naval forces of the United States or of any of the other United Nations and prior to January 1, 1948, should be written into H. R. 4473. S. 942 is a most equitable provision in view of the other congressional provisions presently contained in section 421 of the Internal Revenue Code.
3. H. R. 3168, pertaining to the Virginia Hotel Corp. case should be enacted into law for the reasons stated in Report No. 312 to accompany H. R. 3168.
4. Section 3801 of the Internal Revenue Code should be amended to provide for the allowance of deductions in the proper year, notwithstanding the statute of limitations, where the Commissioner has disallowed the deduction in an open year; provided the proper year for the deduction is within 2 years of the year in which the item was disallowed. In this connection I understand that the American Bar Association has tentatively worked out a provision acceptable by the Treasury Department.

5. The added tax for filing consolidated returns should be reduced from 2 to 1 percent. Years ago when the corporate tax rate was about 30 percent, corporate taxpayers could stand an added 2 percent. With the high corporate rate today, a further tax of 2 percent becomes very important.

6. Consolidated returns should be mandatory where groups of corporations are owned or controlled by the same interest. Making consolidated returns mandatory would have the effect of doing away with a lot of so-called tax avoidance schemes, thus reducing the amount of work before the Bureau of Internal Revenue, the Tax Court, and the appellate courts.

WASHINGTON BANKERS ASSOCIATION,
Seattle Wash., August 2, 1951.

Re taxation of savings and loan associations.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: My attention has been directed to an article in the American Banker under date of July 25, 1951, in which it is stated:

"The 17 State bankers' associations which designated Mr. Tark as spokesman for their officially voted opposition to the tax-free status of the savings and loan associations, in addition to Illinois, are: * * * Washington * * *."

Please be advised that the Washington Bankers Association, whose membership consists of all the State and national banks in this State, has taken no position on this matter nor has it authorized anyone to speak for it regarding such taxation.

This letter is written you for the purpose of keeping the record straight.

Yours very truly,

R. R. KNAPP,
Chairman, Legislative and Taxation Committee,
Washington Bankers Association.

STATEMENT OF WALTER P. REUTHER, PRESIDENT, UAW-CIO

Since July 16, when the Congress of Industrial Organizations presented its recommendations for $10 billions on additional taxes based upon ability to pay, it has become apparent that a concerted drive is on to promote—and, if possible, to persuade the Congress to adopt as permanent policy—a Federal sales tax to be levied either at the retail counter or as a "manufacturers' excise tax."

The National Association of Manufacturers, leader of this latest attack upon the living standards, health, strength, and productive power of American wage-earners and farmers, proposes a sales tax program that would raise the total tax take from families with less than $1,000 a year cash income to substantially more than 50 percent. This would be done in order to obtain a reduction of 25 percent in taxes paid by families in the upper income brackets. It would relieve these families of more than $5 billions in taxes; this burden would be shifted to families with incomes of less than $5,000 a year.

Concentrated economic power seeks to shift tax load to others

As will be shown later, this drive is being made by a more or less united front of certain industrial, business, and financial groups. They represent vast concentrations of wealth and economic power. Their purpose is plain. They propose a scheme whereby, were Congress to enact it into law, they could avoid bearing their fair share of the cost of a defense production program that, within a year, will be costing more than a billion dollars a week. Their scheme would make more inequitable a tax structure that already bears with inequitable severity upon the lowest income groups.

Dissociating themselves from the motives that carry men to the front lines of freedom's defenses against Communist aggression they insist upon getting and keeping the unusual profits of business-as-usual during the most critical emergency our Nation has ever faced; they deck themselves in imaginary rags and patches to warn this committee and the American people of broken hearts and spirit among high- and middle-income persons and corporations unless you "ease the squeeze" on high and middle incomes.

Their formula is simple. They propose to unload the tax burden they are well able to bear. They insist that Congress load that burden upon those least able to bear additional strains upon their living standards. These standards have been shrunken once by inflation since Korea; they are due for further shrinkage in another inflationary upsurge of prices, profits, and trailing wages provided and permitted by title IV of the new Defense Production Act.

Farmers and workers would pay the tax

Both farmers and wage earners are the intended victims of this drive for a Federal sales tax. We quote from section II of the NAM news for May 5, 1951, entitled "Questions and Answers—A Manufacturers' Uniform Excise Versus a Retail Sales Tax," two passages that show how the NAM, since 1940 the leading advocate of a Federal sales tax, thinks a Federal sales tax can be passed on to American farmers and wage earners for them to pay, with legal prohibitions against including the cost of such a tax in their parity prices or cost-of-living wage adjustments:

"Question. Are excise [sales] taxes included in the cost of living (Consumers Price Index) and in the farmers' parity index?

"Answer. Yes, the Federal manufacturers' and retailers' excise [sales taxes] are included in the Consumers Price Index and the parity index.

"Question. Could these indexes be changed if a manufacturers' or retailers' uniform excise [sales] tax were adopted, so as to exclude the tax?

"Answer. Yes. Our information is that this is merely a matter of working out a statistical procedure. *Such a change is necessary if farmers and workers are to bear part of the burden of defense costs. Otherwise the farm parity index and the cost of living index would rise.* Farm income and wage income would then be adjusted to provide the same return after the tax as before." [Emphasis supplied.]

Thus after the mere mater of "working out a statistical procedure," both farmers and wave earners would not be able to apply to the Department of Agriculture or the Wage Stabilization Board for adjustment of their prices or wages to make up for the cut in buying power suffered by them in paying cost plus profit plus sales taxes for everything they bought, except food. Wage earners and farmers together would be required to carry the tax burden of the defense emergency.

As the NAM states frankly in the document already cited—

"Whether the tax is levied at final manufacture or at retail sale, it is an excise or consumption tax. Both may properly be called sales taxes. *Both are intended to be borne eventually by the ultimate consumer, the one who buys for use rather than for resale.*" [Emphasis supplied.]

If a Federal sales tax is passed now or later, no consumer can ever accuse the NAM of having hidden its strictly dishonorable intentions toward the pocketbooks and living standards of 150,000,000 American consumers.

Announced aims can be achieved by a tax on big spenders

Because this drive for a Federal sales tax has broken in full force, bent on victory now or in 1952, and because many billions of dollars in the buying power of wage earners and farmers are at stake, we appreciate this opportunity to present this statement for consideration as part of the committee's record of testimony on the pending tax bill.

We are opposed to sales taxes in any shape or form.

We propose an equitable and more effective way of achieving the announced but incidental objectives of the advocates of the Federal sales tax. Those objectives, they have told the committee, are:

1. to increase the tax yield;
2. to cut down purchasing power, narrow the gap between spendable dollars and available goods during the emergency when defense requires diversion of materials, conversion of plants, and reduction of civilian products and thereby to keep inflationary pressure from blowing off the economic stabilization lid.

But it is significant that a principal reason given by the NAM for preferring the manufacturers' sales tax to the retail sales tax is that the manufacturers' sales tax is hidden from the ultimate consumer who pays it while the retail sales tax is visible, causing pain with every purchase and therefore more likely to be repealed after the emergency is passed. The NAM says in so many words that it wants a permanent, not just a temporary Federal sales tax for the duration of the emergency. Therefore, the second announced objective may be regarded as an attempt to take advantage of the national emergency for permanent private profit.

Our statement will be in three parts. First, we offer our comments on the Federal sales-tax proposals that have been made; second, we shall show how a Federal sales tax would aggravate the gross inequities in the present tax structure; third, we shall outline a proposal for a progressive tax on spending that will increase the tax yield while at the same time decreasing the inflationary pressure.

A progressive spending tax such as we shall outline would discourage excessive spending on nonessentials; it would tend to prevent the bidding up of prices for scarce goods in either legal or black markets. We offer this proposal to show its fair and simple method of accomplishing the purposes claimed for the sales tax by those who hope to use that tax as a substitute for adequate and equitable income and corporation taxes based on ability to pay.

Because on July 31, 1951, the head of the staff of the House-Senate Tax Committee was directed to prepare a report on the sales-tax proposals made to this committee during these hearings, we urge that he be directed to study simultaneously and to report on the equitable and more effective progressive spending tax which we shall describe.

A sales tax is a wage cut

A sales tax, however levied, however concealed and disguised, is a wage cut for workers, a cut in income for farmers. Applied as the National Association of Manufacturers and other spokesmen for high and middle income corporations and individuals are urging you to apply it as a substitute for $23 billion in income taxes—a Federal sales tax would mean a rate of 30 percent and would amount to a wage cut of about $200 a year or $4 a week for the average auto worker with a wife and two children. That would mean a wage cut, imposed by Congress, of 10 cents an hour. For smaller families, the wage cut would be less, illustrating one of the most antisocial features of the sales tax which imposes the heaviest penalties on the largest families.

Under the Committee for Economic Development's proposal that increased tax burdens be excluded from measurement of cost-of-living increases for purposes of wage adjustments under title IV of the Defense Production Act (also suggested by the NAM) such a wage cut would be absolute for the duration of the defense emergency.

Similarly, farmers' parity prices would fall behind increasing costs of the things farmers want to buy.

Sales taxes added to inflation would mean a double wage cut

The appetite of profiteering elements in business and industry seems to grow by what it has been feeding on since Korea Prices and profits climbing higher in an inflationary spiral have cost workers and other consumers more than $17 billions to date; a $7 billion increase in prices for Government purchases has canceled the last increase in taxes.

Having succeeded in getting a new round of higher prices written into the new Defense Production Act that will mean new wage cuts for workers, greater hardship for retired workers on pensions, disabled veterans, servicemen's dependents and all persons living on fixed incomes and the absorption in higher defense costs of all or most of the additional money to be raised by the pending tax bill, these profiteering elements now ask you to impose sales taxes that would increase by more than half the wage cuts already written into the Defense Production Act signed by President Truman under protest.

Although it is impossible to measure accurately in advance the new inflation that will set in when defense production reaches $1,000,000,000-plus per week, it seems conservative to say that the combined effects of wage cuts in the Defense Production Act and in the sales-tax proposals could amount to a drop of more than $550 a year in the purchasing power of a family consisting of husband, wife, and two children and earning $75 a week. This would amount to a wage cut imposed by inflation and taxes of $11 a week or 27½ cents an hour.

Of course, organized workers will continue to chase the devil of inflation around the stump, insisting on cost-of-living as well as improvement-factor wage adjustments. But cost-of-living adjustments will always be 90 days behind the hard facts of higher prices and rents and, when paid, will be in the wooden nickels of inflation.

The new Defense Production Act sentences the American people to another bout with inflation. We urge you to reject the proposal that, at the same time, they also be subjected to a Federal sales tax that would bear down hardest on those least able to pay.

Retailers reveal pyramiding of manufacturers' sales tax

As set forth in Life magazine for July 9, 1951, the united front for a sales tax includes the National Association of Manufacturers, the once reputedly liberal Committee for Economic Development, and the Committee on Federal Tax Policy. Other advocates are the National Retail Dry Goods Association, the American Retail Federation, and the Automobile Manufacturers' Association.

The two retail groups, until now opposed to any sales tax, have been converted to a Federal sales tax, but insist that it be levied at the retail counter. They deserve some thanks from consumers for having pointed out in testimony before this committee that a manufacturers' excise (sales) tax would be built into the cost of the product and is of necessity pyramided and produces additions to the retail price far in excess of the tax imposed (John F. Lebor, American Retail Federation, testimony, July 7, 1951).

Perhaps the retailers' fear is that, caught between the manufacturer and wholesaler on one side and the consumer on the other, they might not be able to pass on to the consumer the full pyramided amount wrapped up in the final price but would have to absorb (pay) some of it.

Our concern is increased by the fact that, during his appearance before your committee, Secretary of the Treasury Snyder seems to have left the door open for a Federal sales tax in the future if, as anticipated by Acting Budget Director Staats, the Federal budget increases to $80 or $90 billions in the fiscal year 1953, dropping to $75 billions in 1954. Secretary Snyder appears to have accepted the contention—which we believe to be unduly pessimistic and defeatist—that a budget of $80 to $90 billions cannot be financed without wrecking our economy—except by taking the last $5 or $10 or $20 billions out of the hides of low-income citizens by a Federal sales tax that would hurt low-income persons most and high-income persons and corporations not at all. True, Secretary Snyder says he is against a sales tax now, but we regret that he has helped the NAM's 5-year plan to fasten such a tax upon the American people, in lieu of income and corporations taxes based on ability to pay.

Needed: A single moral standard in tax policy

Basically, the arguments against further increases in income and corporation tax rates and in favor of a Federal sales tax amount to a threat—a threat by the NAM and its collaborators that defense production will suffer unless income and corporation tax rates are held down or reduced and the additional billions needed for the survival of freedom are taken from the Nation's low-income consumers and awarded to the wealthy few.

It is surprising to find at the core of this argument the unashamed assumption that free enterprise necessarily by its very nature is less patriotic than the men conscripted into our armed services to fight and die for freedom, less dedicated to the defeat of Communist world imperialism than the men and women of organized labor who have consistently accepted, supported, and cooperated in the enforcement of an economic stabilization program including wage stabilization.

Fifteen years of experience in bargaining with many thousands of employees, both persons and corporations, leads us to believe that neither the threat of the NAM and its collaborators nor the assumption on which it is based is wholly true. Once a moral standard is set by our elected representatives in an emergency such as we now face, we believe that most businessmen will fall in line and do their share. Until a code of genuine equality of sacrifice for the duration of this emergency is set, base standards of conduct will tend to drive out good standards, and we will continue to have such insistence upon a double standard as this sample, taken from the testimony of Charles R. Sligh, Jr., chairman of the NAM taxation committee:

"We feel that income, individual income, taxes, for instance, are much more liable to kill incentive to earn than are consumption taxes. Taxing income as it is received is more liable to kill incentive than taxing income as it is spent."

Automobile Manufacturers' Association would spread, not end, the sales-tax evil

Because we believe any increase or extension of excise taxes on necessities is unwise and unnecessary, we deplore the decision of the Automobile Manufacturers' Association to jump from the discriminatory selective excise tax frying pan into the manufacturers' sales tax fire. Chairman A. E. Barit, of the AMA taxation committee, was right on July 31 in opposing the House bill's provision for boosting the excise tax on automobiles from 7 to 10 percent, and particularly in pointing out that the House increase of the tax on replacement parts from 5 to 8 percent would be a tax misfortune, inequitable because it would bear most heavily on low-income persons using old cars whose average age has increased from the prewar figure of 5.5 years to 8 years. But Mr. Barit was wrong in attempting to get rid of the evil of sales taxes on automobiles and parts by spreading the evil to cover all manufactured products on the wholly specious and demonstratably untrue contention that a general sales tax would soak the poor a lot less than the present selective excise (sales) taxes.

The remedy is not to spread the evil, but to do away with and find fair and equitable ways to raise the taxes for a pay-as-we-go defense program.

These ways are at hand. They have been pointed out again and again by the CIO and others.

I. PRESENT TAX LOAD IS INEQUITABLE; A SALES TAX WOULD MAKE IT MORE SO

The well-oiled campaign for a sales tax is a campaign to accentuate the injustices of a national tax structure already iniquitous in its inequities.

It is a campaign to assure the fulfillment of a melancholy prediction made by the staff of the Joint Congressional Committee on the Economic Report:

"* * * those receiving flexible incomes such as dividends and profits and other entrepreneurial returns, which in turn constitute the major portion of the incomes of those in the upper-income brackets, are most likely to emerge from this emergency, as indeed they have from every war in American history, considerably wealthier and better off, both absolutely and relatively, than before. Every war seems to bring its crop of war millionaires."

The drive for a sales tax is a drive to charge the costs of national defense against the living standards of those who can least afford it while turning over the income created in defense production to those who already have far more than they need and much more than is good for the long-term health and stability of the economy.

How taxes are loaded upon those least able to pay

The staff of the joint committee has noted:

"The fact is shocking but true that it is those in the lowest income bracket who already bear a disproportionate share of the tax burden."

This charge is substantiated by a study of the distribution of the tax burden prepared at the University of Michigan. The study shows that spending units with incomes under $1,000 in 1948 paid out a larger proportion of their income in Federal, State, and local taxes than any other group except those with incomes of $7,500 and over.

This unjust tax burden on families with the smallest incomes is in large part the effect of existing sales and excise taxes. The effects of the relatively progressive income tax structure in lightening the tax load on those least able to carry it are largely nullified by regressive sales and excise taxes.

Step by step, up the income structure, sales and excise taxes take smaller proportions of income from the better-off than they do from those with lower incomes.

TABLE I.—*Federal, State, and local excise taxes as percent of income by income groups, 1948*

Spending unit income brackets	Percent of income		
	Federal excise taxes	State and local excise taxes	Total excise taxes
Under $1,000	6.0	5.8	11.8
$1,000-$2,000	5.2	3.9	9.1
$2,000-$3,000	4.8	3.6	8.4
$3,000-$4,000	4.8	3.6	8.4
$4,000-$5,000	4.2	3.4	7.6
$5,000-$7,500	4.0	3.1	7.1
$7,500 and over	2.6	2.0	4.6
Tloal all groups	4.0	3.1	7.1

Source: R. A. Musgrave, J. J. Carroll, L. D. Cook, L. Frane, Distribution of Tax Payments by Income Groups: A Case Study for 1948, National Tax Journal, Mar. 1951, vol. IV, No. 1.

Spending units with incomes under $1,000 are forced to pay out 11.8 percent of those pitifully small incomes in excise taxes while those with incomes of $7,500 and over pay out only 4.6 percent in such taxes. In relation to income, the least well off are saddled with a tax burden more than 2½ times as great as that borne by those in the highest income brackets.

The Federal Government is equally guilty with the State and local governments in perpetrating the gross inequities of the sales and income taxes. Such taxes imposed at the Federal level take 6 percent of income from spending units earning less than $1,000 and only 2.6 percent from those having incomes of $7,500 or more. State and local sales and excise taxes take 5.8 percent of the incomes of those in the lowest bracket and only 2 percent of the incomes in the top bracket.

Poor pay above, wealthy below, average sales tax take

On the average, excise sales taxes took 7.1 percent of income in 1948. Spending units in every income group below $5,000 were forced to pay more than 7.1 percent of their income in such taxes. Based on their incomes, they paid considerably more than their share. Spending units with incomes $7,500 and over, on the other hand, paid substantially less than their proportionate share, based on income, of the total revenues raised from such taxation.

In order to lighten their own contribution to the national defense and to make secure for themselves a disproportionate share of the income created by the national effort to meet the greatest crisis in our history, those behind the sales tax drive would compound the inexcusable injustices of our present excise tax structure by throwing even more of the burden on families who now pay taxes out of incomes, that, before taxes, are insufficient to buy the basic necessities of life.

In place of equality of sacrifice, the sales taxers propose to aggravate existing inequalities by shifting their share of the burden of defense sacrifices to others. According to the Wall Street Journal of July 6, 1951, Chairman Charles R. Sligh, Jr., of the NAM taxation committee, appearing before your committee.

"* * * advocated broadening the Federal tax base by 'substantial use of consumption taxes.' He was particularly enthusiastic about an excise to apply to all end products except food and food products, with tobacco and alcoholic beverages taxed separately at present rates.

"*Mr. Sligh advocated manufacturers' excises as a method of bringing in revenue close to the $28 billion a year now collected through the individual income tax.*" (Italics supplied.)

What this NAM proposal would have meant as of 1948 in terms of redistribution of the tax burden can be seen from the following table. It must be emphasized that, with the rise in income taxes since 1948, substitution of sales taxes for income taxes at the present time would have much more drastic effects than the table shows, both in adding to taxes on low-income families and in relieving upper income families of their share of the tax load.

TABLE II.—*Taxes paid and percent of income paid out in taxes by spending unit at various income levels as of 1948 under then existing taxes and under NAM proposal*

Income group	Taxes paid [1]		Tax liability under NAM proposal [2]	
	Billions of dollars	Percent of income	Billions of dollars	Percent of income
Under $1,000	1.1	28.1	1.9	51.3
$1,000 to $2,000	3.4	24.3	4.3	30.9
$2,000 to $3,000	7.5	25.9	8.9	30.7
$3,000 to $4,000	9.2	26.1	10.5	29.8
$4,000 to $5,000	6.8	26.0	7.3	27.8
$5,000 to $7,500	8.8	27.6	8.3	25.9
$7,500 and over	20.5	36.3	16.1	28.5
Total	57.3	29.2	57.3	29.2

[1] Musgrave, supra, table 6.
[2] For derivation see exhibit 1.

In all NAM's history of blind, reckless, and socially irresponsible greed there has never been an example of heartless rapacity to compare with that revealed in the above table. The NAM proposes that Government to take in taxes more than 51 cents out of every dollar of cash income earned by families with incomes below $1,000 a year. They would become sharecroppers, compelled to give up to Government half of the meager fruits of their labor, of their inadequate pensions, of their payments from public relief agencies and private charities, so that the NAM's constituents, freed of bearing their fair share of taxes, could spend more liberally and save more avariciously.

As of 1948, the NAM's proposal would have reduced by $5 billion the tax burden on families with incomes ranging upward from $5,000 and shifted an equivalent burden onto those with incomes below $5,000. More than $3 billions of the savings in the upper brackets would have been gained at the expense of those with incomes of less than $4,000 a year.

Less for the needy; more for the greedy

As of 1951, total personal income is higher than in 1948 and income tax rates have increased even faster than total income. Thus the tax burden to be shifted to the lower income groups by substituting sales for income taxes is now much larger and the potential savings to the NAM's supporters correspondingly greater than in 1948. The proposed steal from the needy for the benefit of the greedy, which this committee is asked to authorize, is now considerably greater than the $5 billions which the NAM's proposal would have yielded 3 years ago.

In terms of its impact on individual families, the NAM proposal as of 1948 would have been equivalent to a wage cut of $133 a year, $2.56 a week, or 6.4 cents per hour for spending units whose breadwinners earn less than $1,000 a year. For those earning $7,500 or more the NAM seeks an income increase averaging $1,760 a year, $33.85 a week or 84.6 cents an hour on the basis of the 1948 situation.

For reasons noted above, both the wage cuts for the low-income groups and the hand-outs to those in the higher brackets would be substantially greater as of 1951 than would have been the case in 1948.

To carry through its program, the NAM demands, in effect, a sales tax on all goods except food, liquor, and tobacco that, at the retail level, would have equaled the fantastic rate of 32.6 percent in 1948, and would be substantially higher now. If a tax were levied at the manufacturers' level to yield the amounts necessary to replace the revenues from present personal income and special excise taxes (except liquor and tobacco), pyramiding of the tax burden through maintenance of percentage mark-ups on manufacturers' prices would raise the impact at the retail level substantially above the incredible percentage implicit in the NAM's proposal. At every step in the distribution process, the claim would be advanced that costs had been increased by the necessity for more working capital to support inventories made more expensive by the tax passed on from the manufacturer.

The tax bite on the lowest income consumers as of 1948 would, in consequence, have been considerably greater than the 51 percent of income that emerges from direct application of the NAM's proposal without the profit pyramiding that can be expected to be added to it in practice in a sellers' market.

II. TAX HIGH INCOMES MORE TO REDUCE INFLATIONARY PRESSURE

The advocates of the sales tax mask their true motives behind the argument that such a tax would abate inflationary pressures by diminishing excessive consumer spending. They rely heavily on the glib and superficially plausible theory that there are so many more families at low than high income levels that, to be effective, an attack on spending must be aimed at persons and families in the lower income brackets.

The fact that this theory has been repeatedly demonstrated to be at odds with the facts has not deferred the sales taxers from persisting in their efforts to mislead the Congress and the public. In Detroit, one of the three major daily newspapers has gone so far as to publish concocted figures, for which it refuses to give any source, in order to bolster this tottering theory against the weight of the evidence. What is truth worth when there are billions to be gained by twisting it?

If spending is to be diminished, as we agree it must in the present national crisis, it should be at the expense of the luxury standards of the few who have too much rather than the living standards of the many who have too little. This

Nation will be able to produce neither the soldiers nor the weapons it needs if fighters, workers, and farmers and their families are deprived of the means to maintain their health and strength. Neither the men in uniforms nor the men in overalls can be expected to have the morale that it takes to produce and fight effectively if they are made to bear the sacrifices of defense while others exploit the national emergency for personal gain.

Where is the spending money that can best be taxed?

The CIO has already presented to this committee, and we repeat here because of their importance, data derived from authoritative Government sources showing that the 10 percent of spending units with the highest incomes account for as large a share of all consumer expenditures as the 50 percent with the lowest incomes.

TABLE III.—*Distribution of personal income and expenditures, 1948* [1]

Spending units ranked according to income	Range of money income	Personal income after taxes [2]		Net savings, billions of dollars	Expenditures	
		Billions of dollars	Percent of total		Billions of dollars	Percent of total
Highest tenth	Over $6,000	$51.6	29.0	$8.5	$43.1	25.8
Second	$4,800 to $6,000	26.7	15.0	2.1	24.6	14.7
Third	$3,750 to $4,800	21.4	12.0	1.0	19.8	11.9
Fourth	$3,200 to $3,750	17.8	10.0	.7	17.1	10.2
Fifth	$2,840 to $3,200	16.0	9.0	.6	15.4	9.2
Sixth	$2,400 to $2,840	14.2	8.0	.2	14.0	8.4
Seventh	$2,000 to $2,400	12.5	7.0	−.1	12.6	7.5
Eighth	$1,500 to $2,000	8.9	5.0	−.3	9.2	5.5
Ninth	$800 to $1,500	7.1	4.0	−.5	7.6	4.5
Lowest tenth	Under $800	1.8	1.0	−1.9	3.7	2.3
Total		178.0	100.0	10.0	167.1	100.0

[1] 1948 data used because 1950 figures are not yet available and because 1949 was a recession year.
[2] Excludes income in kind and change in value of farm inventories.

Based on income and savings estimates of Department of Commerce, and on distribution of income and savings estimates in Federal Reserve Board Survey of Consumer Finances.

Families in the top-income 10 percent, in other words, spend five times as much, on the average, as the families in the lower half of our income structure. If spending by the top-income tenth were reduced only to the level of the second-highest tenth, that alone would, in 1948, have curtailed total spending by $18.5 billions. Those affected by such a reduction would still have been left better off in terms of living standards than 80 percent of the American people.

The nonessential spending—the fat which can be reduced without harm either to the spenders or the economy—lies obviously in the upper parts of the income structure. At lower levels, there is only the essential bone and muscle of spending on the necessities of life. The sales taxers, however, propose to reduce spending by families who live on or below the margin of necessity. Having lighened the tax burden on themselves and thus increased their own spending potential, they could and would compete with defense production for scarce manpower and materials that should not be diverted to luxury goods and services.

High incomes are biggest contributors to inflation

Sales taxes, by their very nature, can be effective in reducing spending only at the lower levels of the income structure where spending is already, in most cases, inadequate to sustain health and decency. Such taxes do not compel the upper-income groups to deny themselves anything of consequence. At worst, the well-to-do merely pay a little more for what they buy and save a little less. If sales taxes were to replace income taxes, as the NAM proposes, the well-to-do could actually save more while they spend more. If sales taxes were enacted at a level high enough to be effective in deterring spending by upper-bracket families, such exactions would make life impossible for families in the lower-income groups who would find basic necessities priced far beyond their reach.

Scarcities and inflationary pressures will be greatest in the durable goods segment of the civilian economy. Tax discussions too often overlook the obvious and important fact that the greatest contributors to inflationary demand for durables are those with the largest incomes. In 1948, the 5 percent of the spending units at the top of the income structure accounted for roughly 20 percent of all spending on durable goods—four times their proportionate share. The lowest income 50 percent of all spending units accounted for 22 percent of total spending on durables—less than half their proportionate share. For each dollar spent on durables by the average family in the bottom half of the income structure, almost $10 was spent by the average family in the top 5 percent.

Increased sales taxes would undoubtedly affect the small amounts which might be spent for durables by the low-income families. They would deter spending little if at all by the upper-bracket families who spend 10 times as much for durables. Will an additional tax of $25, $50, or even $100 on a refrigerator force a $50,000-a-year family to substitute an icebox for a refrigerator in its new country home?

The NAM recommends to this committee a tax net which would let the big spending fish through while catching the small ones.

After taxes, top 10 percent have more left than have bottom 50 percent

By carrying further the improvements in the income-tax structure proposed in the House tax bill, this committee can reduce nonessential spending out of current income. Present tax rates are not suited to the present emergency requirement that such spending be discouraged and drastically reduced.

Data presented to the House Ways and Means Committee by Secretary of the Treasury Snyder on February 5, 1951, show the inadequacy of our present income tax as a curb on excessive spending by persons in the upper income brackets. Mr. Snyder's figures reveal that in 1951, under the present tax structure, the 10 percent of the Federal income taxpayers reporting the highest incomes will have in the aggregate more income remaining after paying the tax than the combined income after taxes of the 50 percent with the lowest incomes.

TABLE IV.—*Distribution of adjusted gross income, income tax and income after tax of Federal income taxpayers ranked by size of income, 1951, under present tax law*

Taxable returns ranked by size of income	Adjusted gross income		Income tax	Income after taxes	
	Billions	*Percent*	*Billions*	*Billions*	*Percent*
Highest tenth	$55.1	32.2	$12.1	$42.9	28.9
Second highest tenth	23.1	13.5	2.7	20.4	13.7
Third highest tenth	18.5	10.8	1.7	16.8	11.3
Fourth highest tenth	15.7	9.2	1.4	14.3	9.6
Fifth highest tenth	14.5	8.5	1.2	13.3	9.0
Lowest half	44.1	25.8	3.3	40.9	27.5

Source: Based on statement of Secretary of the Treasury Snyder before the Committee on Ways and Means of the House of Representatives, Feb. 5, 1951, table 12. Data by deciles read off chart plotted from figures in table.

We do not understand how Mr. Snyder was able to deduce from his figures the policy conclusion that, "The bulk of any major increase in individual income tax revenues will * * * come from the lower taxable brackets."

The analysis of the Treasury estimates of the distribution of 1951 taxpayer income presented in the table above shows, instead, the great possibilities still available for making substantial inroads on excesive inflationary spending by taking the major share of needed increases in individual income tax revenues from the upper layers of the taxpayers, those best able to pay.

Backstop the income tax with a progressive spending tax

The CIO, in testimony before this committee, has shown how revenue can be raised equitably to put us on a pay-as-we-go basis. If the CIO's recommendations are followed, taxes will take out of current consumer and business incomes as much additional purchasing power as the Government will pour into the economy for defense purposes.

In combination with and reinforced by effective controls over prices, wages, salaries, business credit, the allocation of scarce materials, and so forth, pay-as-we-go personal and corporate income taxes based on ability to pay may stem the inflationary flood.

An equitable and adequate income tax program can bring demand more closely into balance with supply, insofar as demand is dependent on current incomes.

The balance could be upset, however, if people and businesses saved less than usual or if they drew on past savings to maintain or increase nonessential spending in the face of reduced supplies available for the civilian economy.

If that happened it would be necessary to take further steps aimed directly at reducing nonessential expenditures out of savings, actual or potential.

But who does the saving? Is it the lower income families, those who would be hit hardest by a sales tax? Or is it the upper income groups on whose spending a sales tax would have only negligible effect?

Federal Reserve Board figures supply the answer. In 1948,[1] the top-income 10 percent of all spending units had 44 percent of all liquid assets—potentially the most inflationary form of savings. The bottom-income 50 percent of spending units had 22 percent.

The top-income 10 percent accounted for 80 percent of all net saving put aside during the year 1948. The bottom-income 50 percent went into debt or used up past savings to an extent equal to 26 percent of total net savings by all spending units combined.

Who holds the stocks and corporate bonds and other nonliquid assets that can readily be converted into cash for spending? The story is essentially the same. Among the top income 5 percent of all spending units, more than a third held corporate stock in 1948. Only about 1 out of 20 spending units with incomes below $5,000 owned any corporate stock.

Only the top-income groups enjoy the dual luxuries of heavy spending and heavy saving. Low-income families lack means to do either, and excise taxes would force them to do less of both to the detriment of their health, productive efficiency, morale, and economic security.

Progressive income taxes can reduce excessive spending out of current incomes. A progressive spending tax would back-stop the income tax by reducing excessive spending out of both income and savings.

III. A PROGRESSIVE SPENDING TAX—TAILORING THE TAX TO FIT THE INFLATIONARY CRIME OF SPENDING TOO MUCH

As defense production takes hold, it will bite much more deeply into our productive resources than it does now. Revenue needs to support a pay-as-we-go policy will be greater; the need to curtail nonessential consumer spending will be more acute.

If defeated this year, the advocates of the sales tax will intensify their efforts in 1952, using the need for more revenue and less spending as their excuse. They no doubt hope for aid and comfort from the report on sales-tax proposals which the head of the staff of the House-Senate tax committee has been directed to prepare.

To meet immediate revenue needs and to prepare for the problems of the future with due weight given to the facts about the distribution of spending by income groups, we urge this committee:

1. To adopt the personal and corporate income-tax proposals of the CIO now;
2. To study the extent to which steeper graduation of personal income taxes in the upper brackets would diminish the threat of excessive inflationary spending on nonessentials;
3. To direct its staff to begin at once to develop for future enactment a progressive spending tax bill designed to discourage and deter upper-income families from injuring the national interest during the emergency by spending at unduly high levels despite increased income taxes and reduced civilian supplies.

The Treasury Department proposed a progressive spending tax to this committee in 1942. The Treasury presented its proposal after extensive study ranging from the broad economic implications to the administrative details of such a tax. As far as we have been able to determine, the proposal was never given adequate consideration in Congress.

The tragic evolution of world affairs since 1942 has now created a situation in which consideration of such a tax is again necessary. We believe it was a mistake to reject it in 1942. We believe it would be a grievous mistake to ignore its possibilities now.

We do not urge that Congress adopt the specific provisions of the 1942 Treasury proposal. The exemption levels recommended by the Treasury were much too low then and subsequent increases in the prive level make them even more seri-

[1] Data for 1950 have not been published yet; and 1949 figures are less applicable to the present situation than 1948 because 1949 was a recession year.

ously inadequate today. There was no need then, nor is there now, for the flat rate tax to be applied to amounts spent below the exemption level the moment total spending exceeded the exemption. The provision for postwar refunds of part of the tax is obviously inapplicable in an emergency of unpredictable duration.

We do, however, urge the most thorough and serious consideration of the essential principles behind the Treasury's 1942 proposal.

How such a tax might be applied

Members of this committee who served on it during World War II will recall those principles. We summarize them here for the convenience of the newer members of the committee and of the general public.

In essence, the Treasury proposed that spending above specified exemption levels be taxed on a graduated basis. To take a hypothetical example, suppose an exemption of $1,500 per person were allowed. In that case a family of four would be liable under the spending tax only if its spending exceeded $6,000 per year. For purposes of this example, we can assume tax rates equal to the surtax rates proposed by the Treasury, which were as follows:

Spending	*Tax rate percent*
Less than $1,000 above exemptions	10
$1,000 to $2,000 above exemption	20
$2,000 to $3,000 above exemption	30
$3,000 to $5,000 above exemption	40
$5,000 to $10,000 above exemption	50
Over $10,000 above exemption	75

Thus, a family of four which spent a total of $7,000 would be liable to a spending tax of 10 percent on the last $1,000 or $100. A similar family which spent $10,000 would have to pay a tax of $1,000. A four-person family spending $25,000 would pay a spending tax of $10,650.

Such a tax would obviously be a powerful deterrent to nonessential spending. Yet, if the exemption level were set high enough, no family would be hampered in the purchase of necessities. Every well-to-do family could maintain a high standard of living—only its standard of luxury would be somewhat curtailed. (No family would be reduced by such a tax to living in the home front equivalent of a Korean foxhole.) Proper exemptions would assure that only nonessential spending would be taxed. Exemptions would protect large families, who would suffer worst under a sales tax.

Spending for necessities should be exempted

Big spenders would be forced to turn proportionately big shares of their purchasing power into the Treasury. Thus the total spending potential would be reduced. The heavy tax penalties on excessive spending would encourage savings, thus limiting current consumer demand and making additional funds available directly or indirectly for borrowing by the Government if total tax revenues were insufficient to finance the full costs of defense plus other Government expenses. The reservoir of savings created by discouragement of excessive spending would also be available for investment in expansion of private plants and facilities.

Individuals would be free to determine for themselves the extent of their own liabilities under the progressive spending tax. If they chose to spend more, they would be taxed more. If they chose to save more, they would be taxed less. The tax punishment would be tailored to fit the inflationary crime of excessive spending. Restraint would be rewarded and inflationary hoggishness would be penalized.

Upper-bracket families would be deterred from obtaining unfairly large shares of an insufficient supply of consumer goods. Discouragement of excessive spending by such families would reduce pressure against price ceilings and would minimize the danger of black markets.

Administratively, the progressive spending tax presents no problems any more complex than many the Treasury confronts in connection with the income tax. The Treasury in 1942 drafted a simple tax schedule—a copy of which is attached to this statement as exhibit 2—which would provide the information needed to calculate the tax.

Savings would, of course, be exempt from the tax. Noninflationary types of spending can also be exempted from the tax without difficulty. The attached Treasury schedule, for example, provides for exemption of cash gifts and contributions, interest and taxes paid, life insurance premiums, annuity and pension payments, outlays for repayment of debt, and loans made to others.

This list could be extended or reduced to include or to eliminate forms of spending deemed advisable. Medical care costs and outlays for housekeeping help by working women and purchases required in connection with employment, for example, could and should be excepted.

Revenue yield would be substantial

Based on experience with the tax, rates could be raised or reduced as civilian supplies were made scarcer or more plentiful by the expanding and contracting needs of the defense economy. The tax could be used as a flexible instrument to expand or contract consumer demand for nonessentials in accordance with changes in the international situation and in the output of our growing productive facilities.

Since we make no specific proposals at this time except the proposal that a progressive spending tax bill be drafted and held in readiness, we make no estimates of the revenue to be derived from such a tax. The yield would depend in part on the efficacy of the tax in reducing spending. The potential yield, however, is obviously great.

The Treasury estimated in 1942 that its proposals then would bring in $6½ billion. Changes in the Treasury proposals which we would urge would reduce the yield somewhat below the percentage of total personal income represented by $6½ billion in 1942. Depending upon the details of the tax, this reduction in percentage of personal income would be substantially offset in dollar terms as a result of the doubling of total personal income since 1942.

We recognize the fact that if this committee rejects, as it should, the sales tax proposals that have been presented by representatives of high income tax payers, the campaign for such taxes will be continued and stepped up in the coming year. We shall continue to fight all such proposals to transfer tax burdens from those best able to pay to those least able to pay. And we shall do everything possible to promote the widest possible understanding of the enormity of the proposed crime against American wage earners, farmers, and all consumers, particularly those in the lowest income brackets who must spend every penny, as received, for the bare necessities of life.

This committee can contribute to thorough understanding of this issue by early publication of all the facts about sales taxes, including a comparison of their effects, income group by income group, with those that could be obtained by the adoption of a progressive spending tax along the lines here proposed.

EXHIBIT 1

Effect of general excise tax (exempting food) replacing personal income tax and Federal special excise taxes except excises on liquor and tobacco, 1948

Income group	Money income		Federal, State, and local taxes		Federal income tax and specified Federal excise taxes (billions)[2 3]	All taxes less Federal income tax and specified excise taxes (billions)[3]	General excise tax proposed by NAM (billions)[4]	All taxes less Federal income tax and specified excise taxes plus general excise tax[3]	
	Percent[1]	Billions[1]	Billions[1]	Percent of income[1]				Billions	Percent of income
Under $1,000...	1.9	$3.7	$1.1	28.1	$0.1	$1.0	$0.9	$1.9	51.3
$1,000-$2,000...	7.0	13.0	3.4	24.3	.9	2.5	1.8	4.3	30.9
$2,000-$3,000...	14.8	29.0	7.5	25.9	2.3	5.2	3.7	8.9	30.7
$3,000-$4,000...	17.9	35.2	9.2	26.1	3.2	6.0	4.5	10.5	29.8
$4,000-$5,000...	13.4	26.3	6.8	26.0	2.8	4.0	3.3	7.3	27.8
$5,000-$7,500...	16.3	32.0	8.8	27.6	4.3	4.5	3.8	8.3	25.9
$7,500 and over.	28.8	56.5	20.5	36.3	8.9	11.6	4.5	16.1	28.5
Total....	100.0	196.6	57.3	29.2	22.5	34.8	[5] 22.5	57.3	29.2

[1] R. A. Musgrave, J. J. Carroll, L. D. Cook, and L. Frane, Distribution of Tax Payments by Income Groups: A Case Study for 1948, table 6.

[2] Specified Federal excise taxes exclude Federal excise taxes on liquor and on tobacco.

[3] Musgrave, op. cit., table 7, distribution of Federal excise tax on liquor and on tobacco estimated from Musgrave, op. cit., tables 1 and 2.

[4] Distribution based on distribution of retail sales less food, liquor, and tobacco, computed from Joint Committee on the Economic Report, The Economic and Political Hazards of an Inflationary Defense Economy, table 8, p. 14. Total retail sales for 1948 from Survey of Current Business Statistical Supplement 1949. Assumes revenue now obtained from income taxes and special excises, other than liquor and tobacco, will be replaced by revenue from general excise (sales) tax.

[5] This amounts to 32.6 percent of all 1948 retail sales except food, liquor, and tobacco.

EXHIBIT 2

[Copy of spending tax schedule drafted by the Treasury Department [1]]

The individual spending tax schedule

(To be used by persons subject to the spending surtax and by persons not eligible to use simplified income tax returns. A simplified spending tax schedule will be available to all other persons subject to the spending tax)

FUNDS AT THE DISPOSAL OF THE INDIVIDUAL

1. Salaries, wages, and other compensation for personal services	$----------
2. Dividends and interest received, including Government interest	----------
3. Rents, royalties, annuities, pensions	----------
4. Withdrawals from business, professions, partnerships, trusts	----------
5. Cash receipts from gifts, bequests, and insurance	----------
6. Receipts from sale of capital assets	----------
7. Receipts from repayment of loans made to others	----------
8. Receipts from borrowing, including debts incurred on installment purchases	----------
9. Cash and bank balances at beginning of year	----------
10. Other receipts	----------
11. Total disposal funds (items 1 to 10)	----------

DEDUCTIONS: NONTAXABLE USE OF FUNDS

12. Cash and bank balances at end of year	----------
13. Cash gifts and contributions	----------
14. Interest and taxes paid, except on owner-occupied homes	----------
15. Expenditures on the purchases of capital assets	----------
16. Life insurance premiums, annuity, and pension payment	----------
17. Outlays for repayment of debt, including installment debt	----------
18. Loans made to others	----------
19. Other nontaxable disbursements	----------
20. Total deductions (items 12 to 19)	----------
21. Expenditures subject to tax (item 11 minus item 20)	----------

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INSULAR LUMBER CO.,
Philadelphia, Pa., August 3, 1951.

THE COMMITTEE ON FINANCE,
United States Senate.

MR. CHAIRMAN AND GENTLEMEN: The Insular Lumber Co., a New York State corporation, has since 1904 conducted lumbering and sawmill operations in the Philippine Islands. Because of the size and nature of the business, it has conducted these operations directly as a domestic corporation and not through any subsidiary company. As a consequence, we have been subjected to taxes on our Philippine income both in the Philippines and in the United States ever since the formation of the independent Philippine Republic terminated the relief formerly accorded by section 251 of the Internal Revenue Code. We understand this committee has heard, or will hear, testimony from other sources on the great urgency for a general revision of American tax treatment of income from foreign sources. We wholeheartedly concur in the need for such action and sincerely hope the committee may find it feasible.

If, however, it is found impossible to undertake at this time the general revision of tax provisions affecting income from foreign sources, we believe the committee's attention can properly be asked to the adoption of some form of immediate tax relief for American corporations in our position so as to at least equalize our position with that of American corporations which operate abroad

[1] Annual Report of the Secretary of the Treasury on the state of the finances for the fiscal year ended June 30, 1948.

through subsidiary companies. Both President Truman and the Treasury Department have approved this objective, and a measure which would afford it has been introduced in the present Congress by Congressman Simpson of Pennsylvania, H. R. 4082 (copy herewith attached).

We strongly urge the committee to give its most serious consideration to the incorporation in the present tax bill of provisions similar to those of H. R. 4082 in order to terminate the discrimination now imposed on American corporations operating abroad through branches and agencies rather than through foreign subsidiaries and in order to carry out the recommendations to this effect made by both the President of the United States and the Department of the Treasury.

We do believe that any such measure should include one provision which does not appear in H. R. 4082. This provision would be an amendment to section 112 of the Internal Revenue Code, would provide that in cases where the election to defer income of a foreign establishment has been taken, such foreign establishment shall be considered to have the same status as a foreign corporation for the purpose of determining gain or loss under the provisions of section 112 (b) (6) upon complete liquidation of such foreign establishment. Such a provision would do no more than to place the foreign establishment on the same basis as a foreign corporation in permitting tax-free remittance of proceeds of liquidation subject to the prior approval of the Commissioner. Without such a provision the liquidation of a foreign establishment would be severely penalized in that it would be possible for assets acquired with taxed United States dollars to again be subject to tax upon liquidation.

Favorable action on the above suggestion would result in further investment of American capital in the Philippines, both from reinvestment of profits and new investment. This would strengthen Philippine economy and, in turn, its defense potential.

MERLE D. THOMPSON,
Chairman, Executive Committee.

[H. R. 4082, 82d Cong., 1st sess.]

A BILL To amend sections 42 and 43 of the Internal Revenue Code to give an option to domestic corporations to report income of foreign branches at the time of receipt of the United States

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 42 of the Internal Revenue Code is hereby amended by adding at the end thereof the following new subsection:

"(e) FOREIGN ESTABLISHMENT INCOME OF DOMESTIC CORPORATIONS.—In the case of a domestic corporation carrying on a trade or business in a foreign country through a permanent establishment situated in that or another foreign country, the gains, profits, and income of such establishment, to the extent that such gains, profits, and income do not constitute gross income from sources within the United States as defined in section 119 (a), may at the election of the taxpayer in its return for any taxable year beginning after December 31, 1950, be treated, subject to regulations of the Commissioner, as nontaxable until the year in which such income is actually received in the United States.

"Such election shall be binding until revoked with the permission of the Commissioner and shall apply to all the taxpayer's foreign permanent establishments during any year that the election is in effect.

"The term 'permanent establishment' means a branch, management, factory, mine, oil well, farm, timberland, sawmill, plantation, workshop, warehouse, office, or other fixed place of business, but does not include a foreign subsidiary corporation."

SEC. 2. Section 43 of the Internal Revenue Code is hereby amended by adding at the end thereof the following new sentence: "In the case of an election to defer the income of a foreign permanent establishment under section 42 (e), the related deductions and credits (including the credit for foreign taxes under section 131) shall be deferred until the year in which the gross income of the foreign permanent establishment is includible in the taxpayer's income under section 42 (e)."

STATEMENT OF JAMES W. HALEY, GENERAL COUNSEL, COAL EXPORTERS ASSOCIATION OF THE UNITED STATES, INC.

Mr. Chairman and gentlemen of the committee, the Coal Exporters Association of the United States, Inc., is an incorporated voluntary association of coal and coke exporters. Purpose of the association is to promote and encourage the increased exportation of the products and byproducts of the coal and coke industries in the United States; to promote and encourage the consumption of United States coal and coke in foreign countries; to cooperate with members of the coal and coke industries and the public on problems affecting the exportation of coal and coke; to prepare, develop, compile, issue, and distribute such written or other information and material as may be deemed advisable to carry out these purposes; to use all lawful means of promoting the general welfare of the exporters of United States coal and coke.

The association's membership handles more than 90 percent of all the coal exported from the United States.

The American coal export business is of course directly related to the American coal-producing industry. We therefore endorse the presentation made to your honorable committee on July 12, 1951, by the National Coal Association on behalf of the bituminous coal producers of the country.

The coal-producing industry of the United States is highly competitive, not only within the industry itself, but with the oil, gas, and hydroelectric industries, all seeking constantly a larger part of the over-all fuel and energy market. The export of United States coals has a healthy and stabilizing effect upon the entire coal industry, and the general economy of our country. To the quantitative extent that our coals are shipped abroad, running time is improved and equalized in the United States mines, labor given more employment, railroad revenues increased, railroad employees benefited, and competition created for gearing production within a reasonable range of peak wartime requirements.

Notwithstanding the fact that the United States is the largest coal-producing country in the world, our coal and coke exports (not including Canada) throughout the years have varied from a few thousand tons a year to the peak export of 47,758,443 net tons in 1947. Due to the fact that Canada is a contiguous country, and the related fact that shipments to Canada are handled differently from our overseas movement, that market has never been looked upon as an export market in the true sense; therefore, any figures cited herein, or in the accompanying table, will not include our coal shipments to Canada, although they are indeed sizable, varying between fifteen and thirty million tons annually.

Important as the export aspect of the coal business is to the general coal-mining industry of the United States, it is of even more significance and consequence to our friends and allies across the seas. It would be impossible, under present conditions, for the European countries to rearm and equip themselves, as we expect them to do, without substantial importations of American coal. We submit that one of the best ways to promote the construction of adequate defenses in Europe in the shortest possible time is to encourage in every way possible the shipment of American coals to our friends and allies in Europe.

We therefore strongly urge your honorable committee and the Senate to reject the action of the House in making still further oppressive excess-profits tax.

It is doubted that there is any industry in America which will feel the impact of an oppressive excess-profits tax as much as the coal-exporting industry.

Of all American industries, it is doubted that there is another one which shows the fluctuations in business activity reflected in the record of the American coal-export business. Naturally, the coal-export business is subject to the same difficulties which beset the coal-producing industry in the United States, such as national strikes, governmental regulations, car shortages, etc. But over and above the many outside influences which bear directly on the coal-producing industry of the United States—and with equal force upon the coal-export industry—the coal exporters of the United States are subject to serious problems of demand within the foreign consuming areas, hazards of ocean shipping, monetary exchange, import licensing, political considerations in foreign countries, and other international problems with which the members of the committee are no doubt familiar.

The story of the coal-export business is told vividly in appendix A attached to my statement.

Examination of appendix A shows that for the four base-period years 1946 through 1949 overseas shipments averaged 25,482,465 net tons.

The table further shows that in the calendar year 1950 overseas shipments were only 2,484,889 net tons, or 9.6 percent of the 1946–49 average.

In 1951, however, it will be noted that in the first 5 months of the year overseas shipments amounted to 10,964,843 net tons and the estimate for the full year 1951 is 33,700,000 net tons, or 132.2 percent of the average for the base-period years.

In all probability, according to present indications, overseas requirements for United States coal and coke in the year 1952 will be close to 50,000,000 net tons, an all-time record.

Is it not manifestly unfair to place high so-called excess-profits taxes on an industry which fluctuates in activity as much as does the coal-export industry, ranging from slightly under 2,500,000 tons in 1950 to almost 34,000,000 tons in 1951, and probably 50,000,000 tons in 1952? While the coal exporters are subjected to high costs and unusual business hazards, they have little, if any, opportunity to use the invested-capital-credit method in computing excess-profits-tax liability. It is necessary for the coal exporters to maintain their organizations and absorb consequent losses in years when there is little or no business. Historically they have done so in the hope that the occasional years of good business will justify their position. Certainly an excess-profits tax such as the one contained in the House-passed bill will discourage and ultimately destroy the American coal-export business, which is now so important to our domestic economy and to our international relations.

I thank you for the privilege of presenting the views of the Coal Exporters Association to your honorable committee.

APPENDIX A

Principal overseas exports of solid fuels (coal and coke) 1946 through May, 1951, and the year 1951 estimated [1]

[Net tons]

Destination	1946	1947	1948	1949	1946–49 annual average shipments to each destination	1950	Percent 1950 of 1946–49 average	1951 First 5 months (actual)	1951 Total per year (estimated)	Percent 1951 of 1946–49 (average)
All South America	1,7[illegible]2,039	2,975,[illegible]	1,893,283	829,[illegible]	1,861,552	1,303,516	70.0	977,317	2,000,000	107.4
Europe:										
Sweden	1,115,043	2,709,083	[illegible]	437,012	1,214,106	140,882	11.6	326,817		
Iceland								4,865		
Norway	753,376	995,295	46,56[illegible]	2[illegible]8	448,879	5,643	1.3	536,221		
Denmark and Faroe Is.	1,0[illegible]64	2,418,165	52,141	10	882,695	6		143,073		
United Kingdom		[illegible],057			168,764	103,579	61.4	1,164,165		
Eire	11	1,02[illegible]	[illegible]		255,547	10,827	4.2	173,416		
Netherlands	1,700,830	2,74[illegible],208	775,600	466,[illegible]	1,422,014	33,629	2.4	1,347,967		
Belgium and Luxemburg	1,665,329	4,86[illegible],766	840,004		1,841,525	71,096	3.9	579,349		
France	5,850,831	13,958,[illegible]	9,884,599	[illegible],691,584	8,596,285	61,558	.7	1,228,902		
Germany		[illegible],202	70,777		31,245	31,333	100.3	872,489		
Austria		102,029	58,447		40,119					
Switzerland	333,523	805,439	420,621	[illegible]6,655	436,560	195,975	44.9	411,308		
Finland	265,370	637,271	6,273		227,229	48,107	21.2	43,603		
Azores	1,608	6,96[illegible]			2,14[illegible]					
Spain			20,1[illegible]		5,0[illegible]9			12,104		
Portugal	4[illegible],25[illegible]	849,4[illegible]2	257,230	184,275	438,[illegible]00	26,378	6.0	67,133		
Gibraltar	9,[illegible]60	156,8[illegible]4			4[illegible],554	21,743	52.3	112,680		
Italy [2]	4,935,962	8,996,43[illegible]	[illegible],416	3,941,911	5,[illegible],932	114,578	2.0	1,795,220		
Free Territory of Trieste			60,385	11,226	17,[illegible]03	10,572	59.1	64,563		
Yugoslavia	59,906			6,548	16,614			5,142		
Greece	91,676	34,056	62,830		47,141					
Total Europe	1[illegible]7,510	41,026,542	17,840,337	9,925,[illegible]	21,775,069	875,906	4.0	8,880,037	29,000,000	133.2
All Africa	877,[illegible]	2,082,907	963,601	[illegible],751	1,134,002	106,554	9.4	464,589	1,000,000	88.2
Japan		[illegible]	[illegible]9,596	1,443,329	540,731	147,218	27.2	583,657		
Other Asia	207,040	353,116	79,207	45,084	171,112	1,195	.7	50,263		
Total Asia	207,040	353,116	798,803	1,488,413	711,843	148,413	20.8	633,900	1,700,000	238.8
Total	21,134,336	46,436,188	21,502,024	12,855,313	25,482,465	2,434,389	9.6	10,964,843	33,700,000	132.2

[1] Includes all coal and coke, but not briquets.

Source: Reports of the Bureau of Mines.

[2] Figures through 1947 include shipments to Trieste.

STATEMENT OF SENATOR THOMAS R. UNDERWOOD

The manufacture of chewing tobacco, particularly plug and twist, has decreased greatly during the past 30 years. The manufacture of these products is still declining. The decrease in manufacture has, of course, been in direct ratio to consumer demand.

Tobacco growers in certain areas have suffered as a consequence of the decreased manufacture and consumption of plug and twist chewing tobacco. This is especially true of those farmers who grow dark air-cured tobacco in the States of Kentucky, Tennessee, Virginia, and Indiana. The dark air-cured types are used in domestic manufacture mostly for chewing purposes and the decline in farm production of this tobacco has followed closely the decline in the manufacture of plug and twist chewing tobacco. The attached tables show the close correlation.

The excise tax on plug and twist tobacco is 18 cents per pound. A moderate rate of slightly more than 1 cent per ounce. This is, however, the highest rate of excise since that of 1875 which was 24 cents per pound. During this century the lowest excise tax on chewing tobacco was 6 cents per pound in April 1902 to July 1909. The present rate has been in effect since February 1919.

The manufacturers of plug and twist chewing tobacco, especially the small manufacturers who rely solely on the manufacture of chewing tobacco for their income, are in the same plight as the growers of dark air-cured tobacco. In both cases their source of income is rapidly drying up.

It is not known to what extent, if any, the present rate of excise tax decreases the consumption of plug and twist chewing tobacco. However, since these products are used mostly by the low-income group of our population, it would appear that a reduction in excise would lead to some increase in consumption. A decrease of 10 cents per pound should have this effect. The rate of excise would then be 8 cents per pound, or ½ cent per ounce.

The reduced rate would result in some loss of revenue. It is estimated that the loss in revenue would be about $4,700,000, an insignificant sum. If this loss to the Treasury would stimulate the consumption of plug and twist tobacco, it would be a great help to both producers and manufacturers.

Plug and twist chewing tobacco manufactured in United States

[Thousands of pounds]

	Plug	Twist		Plug	Twist
1919-23 average	126,792	10,786	1946	51,810	5,773
1924-28 average	107,440	9,142	1947	47,306	5,152
1929-33 average	76,596	6,430	1948	45,346	5,632
1934-38 average	59,068	5,898	1949	41,903	5,586
1939-43 average	52,699	5,847	Decrease in 30 years:		
1944	61,655	6,498	Pounds	84,889	5,200
1945	59,704	6,723	Percent	66.9	48.2

Source: Annual Report on Tobacco Statistics 1950 USDA-PMA.

Production of dark air-cured tobacco in United States

	Acres	Thousands of pounds		Acres	Thousands of pounds
1919-23 average	133,833	109,540	1946	40,800	49,558
1924-28 average	85,950	68,686	1947	35,300	37,195
1929-33 average	64,500	51,978	1948	29,900	34,772
1934-38 average	42,420	35,520	1949	32,100	35,941
1939-43 average	39,400	36,705	1950	28,700	28,649
1944	40,200	44,867	Decrease, 1919 to 1949	101,733	73,599
1945	44,100	43,560	Percent decrease	76.0	67.2

Source: USDA-BAE, Crop Reports.

STATEMENT OF SENATOR MILTON R. YOUNG

Mr. Chairman, certain facts with respect to the manner in which the present excess-profits-tax law affects a small business in the State of North Dakota have been brought to my attention, and I have proposed an amendment to H. R. 4473 to correct what appears to me to be a grave inequity.

The Nodak Ford Tractor Corp. was organized on August 18, 1949. All of the capital stock of Nodak is owned by Smith, Inc., another North Dakota corporation. On August 31, 1949, Nodak acquired all of the assets of a partnership which had been engaged in the distribution of farm machinery at Fargo, N. Dak. The money that was used to purchase these assets came from the sale of Smith, Inc.'s preferred and common stock, from the issuance of Smith, Inc.'s bonds, and from money borrowed by Nodak. All of this money came from the outside and Smith, Inc. in no way depleted its own assets in order to bring about the purchase of this business.

The farm machinery business which was purchased by Nodak had been prosperous for years prior to this sale, and it was because of its sound earning record that Smith, Inc., and Nodak incurred heavy obligations in order to bring about the sale. Nodak is now being further burdened financially and unfairly discriminated against because the present law denies it the tax earning base of the acquired business. The transaction was consummated on August 31, 1949, long before Korea, and long before there was any thought of an excess-profits-tax law. Immediately after the sale of its assets, the partnership ceased to do business, and it was liquidated.

It would appear to me that under these circumstances it would be manifestly unfair to continue to deny to Nodak the excess-profits net income credit which had been built up by the business Nodak acquired, and yet that is exactly what would happen under the excess-profits-tax law as it now exists.

I do not believe that anyone will seriously defend the denial of this credit and I believe that it is realized by all of the tax experts in and out of the Government that this is a gap in the law which is crying for immediate remedial legislation. I have discussed this particular problem and the facts in this case with Mr. Colin F. Stam and he is fully familiar with them. To correct this inequity, I have offered an amendment to H. R. 4473, and I feel confident that it should and will receive early and favorable consideration. Only in this way will an obvious omission be remedied.

AIR TRANSPORT ASSOCIATION OF AMERICA,
Washington 6, D. C., August 6, 1951.

Subject: Hearings on revenue bill of 1951, Federal gasoline tax.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: As you may know, the Air Transport Association of America represents virtually all of the certificated airlines operating under the American flag. Recently Senator Byrd, as acting chairman of the Senate Committee on Finance, by letter suggested that we file a written statement, in lieu of a personal appearance before the committee, setting forth the position of the airline industry relative to the proposed increase in the Federal gasoline tax.

In compliance with the suggestion we are enclosing, for your information, a brief memorandum setting forth what we feel are cogent reasons why the Congress should not impose any additional gasoline tax on the airlines.

We feel that the principal objection to any increase in the gasoline tax is the fact that the burden of the levy will not, and cannot, be spread evenly or equitably over the industry. Since the tax is an arbitrary figure assessed against the purchase of each gallon of gasoline, it bears no relationship to the ability of the particular airline to pay the tax. The smaller airlines are the ones which would be particularly hurt by the increase, the smaller and weaker the airline, the more crippling the burden of the tax would be.

In the air transport industry there are about 40 certificated airlines. They differ greatly in size, in their gross revenues, and in the average percentage of airplane seats which they fill. That percentage varies from 70 percent down as low as 25 percent. The smaller, so-called "local service," airlines, fill on an average of 25 percent of their seats.

Most of the smaller airlines operate DC-3s, which consume about 100 gallons of gasoline an hour, and, on the basis of a 1½-cent increase in the Federal gasoline tax, they would have to pay $3 tax for each hour a DC-3 operated. An airline would have to pay this same $3, whether the airplanes were operated at capacity or whether, as is generally the case of the smaller airlines, only six or seven passengers are being carried.

There is attached to our memorandum a table which shows, for each domestic airline, the percentage which an increase of 1½ cents in the Federal gasoline tax bears to that airline's net operating income, before income taxes, for 1950. In computing that percentage, the gallonage consumed in 1950 was used. The table reveals that of the 32 airlines listed, 7 operated at a loss in 1950. Even for the airline with the largest net operating income the increase in gasoline taxes would constitute 5.2 percent of that income. In one case the increase in tax would be more than seven times the net operating income. The total tax increase would be 9.8 percent of the total net operating income of the domestic airlines. Thus the airlines would be subject not only to the additional income taxes proposed in H. R. 4473, but also to an additional similar burden which is proportionately even higher.

As doubtless you know, Southern Airways, Inc., a local service carrier, serves a considerable number of cities in your State. Based on Southern's gasoline consumption in 1950, an increase of 1½ cents in the Federal gasoline tax would have amounted to 16.3 percent of Southern's net income, before income taxes, for that year, and would have virtually wiped out Southern's profit for the year. I am sure you will agree that the Congress should not impose such a burden on a carrier, or on an industry, so vital to the commerce and national defense of this country.

We urge the committee, therefore, not to recommend the imposition of any additional gasoline tax on the airlines.

Sincerely,

E. S. LAND, *President.*

STATEMENT OF AIR TRANSPORT ASSOCIATION OF AMERICA, WASHINGTON, D. C. WITH RESPECT TO THE PROPOSED INCREASE IN THE FEDERAL GASOLINE TAX

SUMMARY OF STATEMENT

The Air Transport Association of America, which represents virtually all of the certificated airlines operating under the American flag, urges the committee not to impose an additional gasoline tax on the airlines. Gasoline used by the airlines is not a commodity which, under tests prescribed by Secretary Snyder, should be taxed at an increased rate. The proposed increase not only would have a serious impact on the industry, but would discriminate among the airlines, falling particularly heavily on the smaller airlines.

In the hearings before the Ways and Means Committee, Secretary Snyder made two tax proposals which directly affect the airlines. He suggested that the corporate income tax be raised by eight percentage points, and that the present 1½-cent gasoline tax be increased to 3 cents per gallon:

H. R. 4473, as passed by the House, would increase corporation income taxes by five percentage points and, due to changes made in the excess-profits tax, would produce approximately as much income tax revenue from corporations as recommended by the President. We do not raise any question with respect to the proposed increases in income taxes on corporations since they will apply to business generally. They will not be levied so directly and specifically against the airlines as is the proposed increase in the gasoline tax.

H. R. 4473 would increase the gasoline tax from 1½ cents to 2 cents per gallon. In his testimony before this committee, the Secretary pointed out that the net yield of H. R. 4473 is about $7 billion, or roughly $3 billion less than the goal set by the President. The Secretary urged that this gap be closed, and that approximately $2 billion extra revenue be obtained by further increases in "selected excise taxes," including an increase in the gasoline tax from 1½ to 3 cents, as originally proposed to the House committee.

We are greatly concerned with the Secretary's proposal to double the tax on gasoline. The air-transport industry operates on gasoline. It is the heart of our business. It is our basic raw material, as is coal to the steel mills. The domestic airlines will use an estimated 425,000,000 gallons of aviation gasoline during 1951. Consequently, they would be hit particularly hard by such an increase in this tax.

There are three principal reasons why the Congress should not increase the tax on gasoline used by the airlines.

1. Gasoline used by the airlines is not a commodity which, under tests prescribed by Secretary Snyder, should be taxed at an increased rate.

In his statement before the Ways and Means Committee, the Secretary pointed out that additional revenue was to be raised from excise taxes "on those consumer goods which are less essential or which use materials that will be in short supply." The gasoline used by the airlines clearly does not fall in either of those categories.

There can be no question but that continued operation and rapid expansion of the airlines is a prime essential. The Nation's economy has become more and more reliant upon the speed and services of air transportation. Moreover, the increasing tempo of our production machine is going to require rapid expansion of the airline industry. An even further expansion is required by the fact that military plans for airlift requirements generally are hinged upon the use of a high percentage of the commercial airlines' fleet. In a speech in the fall of 1950, the Secretary of the Air Force, in speaking of the requirement for air transport in times of emergency, stated in part: "When we * * * take into consideration * * * not only the military planes available but a practicable percentage of the civilian airlines which might be taken over in the event of war, we find a very substantial deficit." Thus, for both business and military uses the airlines must expand, and the use of gasoline is essential to that expansion.

Nor does the Secretary's reference to materials which are in short supply apply to the gasoline used by the airlines. Presumably he had in mind that a tax imposed on such materials would discourage their purchase and use. But, as stated, it is quite clear that the public interest does not require a reduction in the use of gasoline by the airlines—it requires just the opposite.

2. The proposed increase would have a serious impact on the industry

If the proposed increase is adopted, our conservative estimate is that the industry would pay to the Federal Government in the neighborhood of $13 million a year in gasoline taxes alone, based on 1951 figures. An item of $13 million does not create much of an impression any more, but this amount of money is a very heavy burden to the air-transport industry. The total amount of gasoline taxes which the airlines would pay to the Federal Government under the Treasury Department's proposal would amount to more than their total net profits in 1949, and about 50 percent of those for 1950 and 1951.

There is attached to my statement a table which shows, for each domsetic airline, the percentage which the proposed additional gasoline tax it would have to pay, bears to its net operating income, before income taxes.

A review of that table reveals that of the 32 airlines listed, 7 operated at a loss in 1950. That even for the airline with the largest net operating income, the increase in gasoline taxes alone would constitute 5.2 percent of that income. In one case the increase in tax would be more than seven times the net operating income. Generally, for airlines with comparatively small net operating income, the new tax would virtually wipe out anticipated small profits.

The total tax increase would be 9.8 percent of the total net operating income of the domestic airlines. Thus, the airlines would be subject not only to the proposed additional income taxes, but also to an additional similar burden which is even higher.

Even if it were possible for the airlines to require the air traveler to absorb every bit of the additional gasoline tax, and we do not think it is, it seems unfair and inequitable to impose an additional burden of taxation upon him. He is already paying very substantial taxes for the privilege of riding on an airplane. In the year 1949 the air traveler paid $40,700,000 in transportation taxes. In 1950 he paid $53,200,000, and it is estimated that in 1951, his tax bill will be increased to $66,500,000. It seems to us that the air traveler is paying enough. Apparently the Secretary thought so, too, since he proposed no increase in the transportation tax rate.

Most Federal taxes, unlike the gasoline tax, are expressed as percentages of the tax base. While a tax of 3 cents per gallon, at first blush, sounds rather innocuous, the full burden of the tax can be appreciated when it is expressed as a percentage of the price of the article taxed. The airlines buy their gasoline at prices in the neighborhood of 17 to 19 cents per gallon. A 3 cent tax on a gallon of gasoline purchased at 17 cents amounts to a tax of approximately 18 percent. That is a "luxury tax rate," as witnessed by the fact that the excises on jewelry, furs, cosmetics, and cabaret checks are only 20 percent. But gasoline is no "luxury" to the airlines—it is their life blood.

3. The tax would discriminate among airlines

An even greater objection to the proposed gasoline tax increase is the fact that the heavy burden which it would impose is not, and cannot, be spread evenly over the industry. It is the small airline that is particularly hurt. As a matter of fact, the smaller and weaker the airline, the more heavy the burden of the tax.

Some airlines have a high percentage of long-haul traffic between major traffic centers; others, particularly the feeder lines, serve primarily the smaller cities where the traffic volume is very small. For this reason, the percentage of seats occupied on the airplanes of the various companies will vary from 70 down to as low as 25 percent.

The gasoline tax, which is an arbitrary figure assessed against the purchase of each gallon of gasoline, bears no relationship to the ability of the particular airline to pay the tax. No consideration is given to the earning capacity of the airline, the traffic-producing potentialities of its route, or to the passengers or other cargo that it carries. Most of the smaller airlines operate DC-3's, which consume about 100 gallons of gasoline an hour. On the basis of the proposed tax, they would have to pay $3 tax for each hour a DC-3 is operated. They would have to pay this same $3 even though they were actually carrying only six or seven passengers in the airplane. These smaller airlines, who fill only 25 to 35 percent of their seats, have no way of mitigating the discriminatory effects of the tax except by applying to the Government for subsidy, and it is clearly unsound policy to impose a tax upon an airline and promptly increase Government-subsidy payments in amounts sufficient to offset the tax.

For all of the reasons we have stated, we hope that the committee will not impose any additional gasoline tax on the airlines. We do not believe that such a tax increase is necessary in order to insure that air transportation makes its proper contribution to the additional revenues required. The 15-percent transportation tax, for instance, which is collected for the Government by the airlines, will increase from $53,200,000 in 1950 to about $66,500,000 in 1951, thus providing additional revenue of $13.3 million. This increase is twice the amount which would be collected by a 1½-cent increase in the gasoline tax.

Relationship of proposed increase in gas tax of 1½ cents to net operating income, before taxes, of carriers in 1950

Company	Net operating income	Percent tax increase to net operating income	Company	Net operating income	Percent tax increase to net operating income
	Thousands			*Thousands*	
American	$22,919	5.2	All American	(1)	
Braniff	2,105	8.6	Bonanza	(1)	
Capital	2,237	15.5	Central	(1)	
Colonial	(1)		Empire	$24	54 2
Continental	384	17.9	Frontier	(1)	
Chicago & Southern	704	13.7	Lake Central	28	39.1
Delta	2,151	10.6	Mid-West	34	8.5
Eastern	9,501	9.5	Piedmont	274	13.5
Inland	481	6.7	Pioneer	228	10.2
Mid-Continent	681	11.6	Robinson	(1)	
National	2,470	7.6	Southern	117	16.3
Northeast	121	45.9	Southwest	201	9.6
Northwest	59	(2)	Trans-Texas	142	21.5
TWA	6,087	12.8	West Coast	98	13.4
United	14,218	7.3	Wiggins	(1)	
Western	1,187	9.6	Wisconsin Central	164	7.5

[1] Loss.
[2] Proposed increase in gas tax would be $443,415, or more than 7 times the net operating income.

HAWLEY TRAILER STORES, INC.,
Spokane 63, Wash., August 1, 1951.

Hon. HARRY CAIN,
Washington State Senator, Washington, D. C.

DEAR SENATOR CAIN: I am writing you again regarding the 7-percent excise tax now being imposed on trailer coaches. This excise tax has been imposed for some years on the trailer-coach industry due to the fact that the honorable Members of the Senate and the House of Representatives believe the trailer coach to be a method of transportation, when, in effect, for many years, the trailer coach has been a method of semipermanent housing. It affords the construction worker and military personnel the only known home which is mobile and can be taken from job to job or base to base.

The records of the trailer-coach industry show that 93 percent of the trailer coaches manufactured are used for housing. We feel that the imposition of the 7-percent manufacturer's excise tax is definitely a discriminatory tax on one segment of the population. No other housing bears such a tax. We urgently request that you do your very best to see that trailer coaches are eliminated from the excise-tax provisions.

Thanking you very much for your consideration in this matter, I am,

Sincerely yours,

HAWLEY TRAILER STORES, INC.,
D. H. HAWLEY, *President.*

ALUMINUM CO. OF AMERICA,
Vancouver, Wash., July 31, 1951.

Senator HARRY CAIN,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: Realizing you have always shown a sincere and keen interest in the development of American youth and problems of industry, we are writing to acquaint you with our summer-vacation program of industrial education for precollege and college undergraduates, and to endeavor to enlist your good services to correct that section of the United States income-tax law pertaining to dependent exemptions.

We feel the requirement that a dependent cannot have a gross income of $500 or more is not realistic and is working a great hardship on all phases of American industry, in that the productive effort of countless thousands of American youth is lost to our national economy for several weeks each year.

This has come about due to the upward trend in wages for the past several years and as this trend continues the problem will become more acute.

Attached to this letter are copies of our summer-classwork program and management bulletins describing our plan.

This year, at the request of a number of the boys, and because of the $500-dependent-exemption problem, we thought it advisable to change the classwork part of our program from 10 to 8 weeks.

We have made the number of weeks of work experience optional; however, indications are that we will lose the services of the majority of these summer workers when they will be needed most and at a time when their training would have made them most effective.

We respectfully urge your consideration of this problem faced by American industry and hope a solution through your efforts is possible.

Very truly yours,

ALUMINUM CO. OF AMERICA,
H. W. GILES, *Personnel Manager.*

KENT-COFFEY MANUFACTURING CO.,
Lenoir, N. C., August 6, 1951.

The Honorable WALTER F. GEORGE,
Committee on Finance, United States Senate,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: I, Harold F. Coffey, president of the Kent-Coffey Manufacturing Co. of Lenoir, N. C., submit herewith the following facts and figures which show this company's predicament under the relief provisions of the existing excess profits tax law. A careful examination of the facts in this case discloses the complete inadequacy of the existing excess profits tax relief provisions in affording any relief whatsoever in hardship cases such as beset our company.

By way of qualification in making the statements hereinafter, I would like to state that I have been with the Kent-Coffey Manufacturing Co. since its organization, beginning as a factory workman and serving in various capacities, including that of executive vice president and sales manager for more than 25 years prior to 1948. Since my father's death in 1948, I have served as president and general manager.

ORIGIN AND HISTORY

This company is a manufacturer of wood bedroom furniture and began business in 1907, with a paid-in capital of $33,800. By consistently plowing back its profits, after income taxes, into plant expansion to take care of the increased demand for its product, the company is enjoying an increased volume of sales, which for the fiscal year ended November 30, 1950, exceeded $5,000,000.

The company's sales are widely distributed in the United States, Canada, Mexico, and Hawaii.

At November 30, 1950, the company had 596 employees at its factory location and 27 commission salesmen, a total personnel of 623.

Although the foregoing sales volume is stated in millions which looks big to us, when compared with the corporations comprising industry as a whole, we are definitely in the small-corporation class. I assume that you have already been furnished figures showing that it was the small corporation that was hardest hit in the previous excess profits tax law for the reason that they did not have the comparable credit to that of the larger corporations, either by the earnings or invested-capital method.

HIS COMPANY'S PREDICAMENT

In the light of the excess profits tax act of 1950 using the base period earnings (1946–49) as the basis for a credit, this company finds itself in this predicament:

1. During the base-period years (1946–49) and to November 30, 1950, this company, using earnings and borrowed capital, made the following expansion of its plant and equipment:

Plant and equipment Nov. 30, 1946		$520,064.47
Additions fiscal year ended Nov. 30, 1947	$54,434.10	
Additions fiscal year ended Nov. 30, 1948	124,412.90	
Additions 19 months ended June 30, 1950	848,973.65	
Plant expansion to June 30, 150		1,027,820.65
Plant expansion June to November 1950		14,446.35
Plant and equipment Nov. 30, 1950 (per exhibit A)		1,562,331.47

You will notice by the foregoing that the major plant expansion extended over a 19-month period to June 30, 1950, and as 1949 is the last year of the base period, this period of expansion extended 10 months beyond the close of the base period.

In making this expansion, it was necessary to demolish a large area of wooden buildings and replace them with modern standard mill construction, consisting of brick walls, steel beams, and standard 5-inch factory flooring. The productive floor space was increased to 388,751 square feet, an increase of approximately 104,000 square feet. Included in this expansion was the installation of new and modern machinery, laror-saving devices, conveyorized equipment and a system of quality control, which together with the increased productive floor space should produce an annual earnings credit considerably in excess of any year shown in the base period years.

2. Of the 19-month period of plant construction and renovation, the 18 months ended May 30, 1950, was the most affected by the interruption made necessary by the expansion program, and in this 18-month period, the company sustained an actual loss of $30,287.88. The management was confronted with the choice of closing the plant down completely and concentrating all efforts on building for a period of 6 to 8 months, or of building practically a new plant around the workmen and suffering the consequent loss of production of goods during the period of construction. The latter course was chosen, resulting in the dollar loss just stated. To close down completely for such an extended period would have entailed

the disruption of the plant organization and the permanent loss of some skilled workmen who could not remain unemployed for such a length of time, thereby requiring years to train new personnel to the degree of skill and efficiency existing prior to the time of interruption. Likewise, with no product available for sale, contact with the customer would have been lost, the sales force would have been forced to disband, all of which would have required a long uphill pull of reactivating the sales force and regaining anything like the previous status with the trade.

3. For purposes of this discussion, the fiscal years ended November 30 are used, being within 1 month of the base period requirements, and net income is used as excess profits net income as the necessary adjustment to arrive at excess profits net income would be less than 1 percent.

By referring to exhibit B, attached hereto, you will note that the company had net earnings before income taxes for the base period as follows:

Fiscal year ended—	4 years	3 best years
Nov. 30, 1946	$338,938.41	$338,938.41
Nov. 30, 1947	559,865.62	559,865.62
Nov. 30, 1948	737,813.97	737,813.97
Nov. 30, 1949	174,635.40	0
Total	1,811,253.40	1,636,618.00
Average	452,813.35	545,539.34

An average 4-year earnings of $452,813.35 or a three-best-year average of $545,539.34 would be a severe handicap to this company as either credit would not reflect the substantial and consistent growth during the base period, and above all, would not reflect the profits they could have earned with the new and modern plant with the increased productive floor space and improved facilities.

The plant expansion and installation of improved facilities was practically completed by May 30, 1950. As an index of what the company could have done under the improved facilities, the following actual net profits for the 6-month period, May 30 to November 30, 1950, and the 6-month period, December 1 to May 30, 1951, are shown:

Net profits, May 30 to Nov. 30, 1950	$451,203.15
Net profits, Nov. 30, 1950, to May 31, 1951	330,267.28
Total net profits for first year following completion of plant expansion	781,267.28

This figure, although an index of the effect of the plant expansion, is inadequate for the reason that the full effect was not felt for the full 12 months, as it required part of the year to "get in high gear."

The profits earned for the year ended May 30, 1951, did not include any war contracts, and so far as the officials of this company know, none of its product was sold for housing projects connected with the war effort.

APPLICATION OF FACTS TO EXISTING RELIEF PROVISIONS

The various methods of relief afforded by the existing law have been applied to the facts in this case. In order to see the effect of the application of the relief provisions, the following figures are necessary. The adjusted basis of plant and equipment as of the close of each base period stated in round figures was as follows:

1946	$334,000
1947	372,000
1948	473,000
1949	959,000

The total assets of the company as of the close of each base-period year stated in round figures were as follows:

1946	$1,414,000
1947	1,734,000
1948	2,227,000
1949	2,348,000

The secretary's published tentative rate of return (Code 25, Furniture and Fixtures) for the base period is compared with that of the Kent-Coffey Manufacturing Co. as follows:

	Kent-Coffey's rate of return	Industry rate of return
	Percent	*Percent*
1946	27.6	16.4
1947	36.6	16.4
1948	36.9	14.6
1949	8.4	13.7

Section 444 (b) obviously was intended to apply to cases such as this. Kent-Coffey Manufacturing Co. meets the technical requirements of this provision, but the application of it to the facts in this case affords no relief whatsoever. The adjusted basis of the company's plant and facilities on the last day of the base period was more than 200 percent of the basis of these facilities at the beginning of the 36-month period. In addition, Kent-Coffey's capacity for production at the close of the base period obviously was more than 150 percent of its capacity at the beginning of the 36-month period. However, applying the rule set forth in section 444 (c) produces an average earnings of only $360,000 (15.3 percent of total assets as of the close of 1949 of $2,348,000). This figure is substantially below the company's average base-period earnings computed without the correction for abnormality and shows the total inadequacy of this relief provision.

Likewise, it is clear that the company technically qualifies for relief under section 442 (a) (1) because normal production, output, and operations were interrupted or diminished because of the rebuilding of the plant in 1949. By reference to the measure of relief, however, afforded by section 442 (e), again it will be seen that this provision is totally inadequate. Kent-Coffey's assets as of the close of 1949 were $2,348,000. The Secretary's tentative rate of return for the furniture industry for 1949 is 13.7 percent. This would produce a substitute income for 1949 of $321,000. This figure for 1949, of course, would not increase the company's average earnings credit under any of the above-indicated methods.

The following information was taken from the Statistical Income Reports of the United States Treasury Department. The first 2 years had only one classification: "All forest products." The remaining years are classified as "Code 25: Furniture and fixtures." These figures are compared with the comparable statistics of the Kent-Coffey Manufacturing Co.:

Year	Code 25: Furniture and fixtures			Kent-Coffey Manufacturing Co.		
	Assets (000 omitted)	Net income (000 omitted)	Ratio	Assets	Net income	Ratio
			Percent			*Percent*
1936	$2,241,607	$73,068	3.3	$918,261	$56,509	6.2
1937	2,178,807	84,797	3.9	876,773	18,354	2.1
1938	967,424	17,100	1.8	846,912	(35,900)	(4.2)
1939	987,024	50,659	5.1	888,346	68,925	7.8
1940	1,046,882	68,486	6.5	892,316	138,853	15.6
1941	1,103,210	143,956	13.0	1,058,748	201,439	19.0
1942	1,077,196	149,014	13.8	1,204,722	233,675	19.4
1943	1,067,341	145,262	13.6	1,188,891	41,578	3.5
1944	1,119,324	168,596	15.1	1,063,083	118,706	11.2
1945	1,141,579	138,413	12.1	1,034,849	343,123	33.2
1946	1,486,431	243,774	16.4	1,228,246	338,938	27.6
1947	1,760,856	289,764	16.4	1,531,426	559,865	36.6
1948	(1)		14.6	2,001,714	737,814	36.9
1949	(1)		13.7	2,087,661	174,635	8.4
Total, 14 years			149.3			223.3
Average, 14 years			10.7			16.0

[1] Not available.

These figures demonstrate clearly the sustained superiority of Kent-Coffey's earning power as measured by total assets over that for the entire furniture industry throughout this entire period. These figures are given to show that the ratios between this company and the industry during the base-period years are not fortuitous nor an isolated example of the earnings of this company as contrasted with those of the industry as a whole. All these figures show that to replace abnormal experience in Kent-Coffey's base period with industry averages affords no measurement whatsoever of what reasonably could be expected for the period of the abnormality if the abnormality were corrected. To substitute industry average figures for abnormal periods harshly penalizes the efficient units, and conversely constitutes an undeserved windfall for the inefficient units.

If Kent-Coffey were given for 1949 a yearly rate of return on its assets bearing the same ratio to the Secretary's published rate of 13.7 percent which Kent-Coffey's rate of return for the first 3 years of the base period bears to the Secretary's published rate of approximately 15.8 (15.8 : 30 percent : 13.7 : 26.1 percent), a substituted earnings figure for 1949 of $613,000 would result (26.1 percent of 1949 assets of $2,348,000). If this figure of $612,000 were substituted for the actual earnings of $175,000 for 1949, then the company's average earnings for the entire base period would be $562,000 instead of $453,000, and would be slightly more than the company's earnings of $546,000 for its three best years computed without the substitution for 1949. If the substitution for 1949 is made, then Kent-Coffey's earnings for its three best years would become $640,000 (three best years: 1947, $569,000; 1948, $738,000; 1949, $613,000).

From the above, it is clear that the relief provisions in the existing law are completely inadequate and inappropriate as applied to the facts in the company's case. It not only is entitled to fill in its wholly abnormal 1949 earnings with a reasonable level of earnings, but it also should be entitled to treat its base-period earnings after such substitution to the rule permitting the use of the three best years.

CONCLUSION

We strongly urge, first, that the substituted earnings during the period of construction, in our case the year 1949, be based on our own experience, and not that of the general industry-wide average alone; and, second, that the rule of permitting the use of the three best years be applied after having substituted such earnings for the period of construtcion.

Only by these means can companies such as ours, whose earnings were materially reduced during the period of expansion, be allowed an earnings credit comparable to those companies whose earnings were not reduced by the interruption of plant expansion. Even such a credit would allow nothing for the increased capacity as the result of plant expansion.

We hope your committee will see fit to enact into law such provisions as will afford relief merited by the conditions herein outlined.

Respectfully submitted.

KENT-COFFEY MANUFACTURING CO.
By HAROLD F. COFFEY, *President.*

EXHIBIT A

Comparative balance sheets

	Fiscal year, Nov. 30, 1946	Fiscal year, Nov. 30, 1947	Fiscal year, Nov. 30, 1948	Fiscal year, Nov. 30, 1949	Fiscal year, Nov. 30, 1950
ASSETS					
Cash	$50,727.37	$56,813.68	$192,830.05	$76,709.83	$167,818.16
Accounts receivable	296,254.36	373,375.93	537,209.56	390,387.45	564,964.02
Notes receivable			5,000.00		1,817.00
Inventories	486,185.41	648,804.14	710,803.46	505,928.10	972,880.07
Cash value life insurance	30,787.50	36,013.25	41,922.15	84,071.10	53,787.16
Plant and equipment	520,064.47	574,498.57	698,911.47	1,219,330.93	1,562,331.47
Prepaid expense	4,145.49	18,178.13	14,775.62	35,215.16	26,494.20
Stock in other corporations	26,000.00	26,000.00	26,000.00	72,000.00	72,000.00
Total assets	1,414,164.60	1,733,683.70	2,227,452.31	2,347,642.57	3,422,092.08
LIABILITIES					
Accounts payable	48,153.22	43,346.10	43,785.31	79,300.38	170,470.97
Notes payable	125,000.00		5,000.00	200,000.00	735,000.00
Accruals	122,956.34	288,401.11	376,219.29	146,709.44	288,254.58
Reserve for depreciation	185,917.71	202,257.22	225,737.54	259,981.19	312,873.78
Preferred stock	30,000.00				
Common stock	400,000.00	400,000.00	400,000.00	400,000.00	400,000.00
Surplus	502,137.33	799,679.27	1,176,710.17	1,261,651.56	1,515,492.75
Total liabilities	1,414,164.60	1,733,683.70	2,227,452.31	2,347,642.57	3,422,092.08

EXHIBIT B

Analysis of net profit and surplus

	Fiscal year, Nov. 30, 1946	Fiscal year, Nov. 30, 1947	Fiscal year, Nov. 30, 1948	Fiscal year, Nov. 30, 1949	Fiscal year, Nov. 30, 1950
Net profit, 5 months				$209,843.42	
Net loss, 7 months				−35,208.02	
Net profit, first 6 months					$4,920.14
Net profit, last 6 months					451,203.15
Net profit, fiscal years	$338,938.41	$559,865.62	$737,813.97		
Net profit for period	338,938.41	559,865.62	737,813.97	174,635.40	456,123.29
Less income taxes accrued	150,572.90	232,815.35	307,180.24	66,511.53	201,001.46
Net addition to surplus	188,365.51	327,050.27	430,633.73	108,123.87	255,121.83
Beginning surplus	344,020.57	502,137.33	799,679.27	1,176,710.17	1,261,651.56
Additions:					
Including cash value life insurance	6,719.25	5,225.75	5,908.90	6,148.95	5,716.06
Miscellaneous adjustments		1.62	146.52	1,671.77	
Total	539,105.33	834,414.97	1,236,368.42	1,292,654.76	1,522,489.45
Deductions:					
Life insurance premiums	5,468.00	9,610.70	7,094.95	7,003.20	6,996.70
Preferred stock retired	1,875.00				
Preferred stock dividend	5,625.00	1,125.00			
Common stock dividend	24,000.00	24,000.00	48,000.00	24,000.00	
Miscellaneous adjustments			4,563.30		
End surplus balance	502,137.33	799,679.27	1,176,710.17	1,261,651.56	1,515,492.75

STATISTICAL

Volume of sales	$3,303,333.36	$4,111,755.42	$5,205,113.72	$3,745,881.20	$5,076,318.47
Percent net return on net profit after taxes	5.7	7.9	8.3	2.9	6.4
Percent invested capital	20.21	27.26	27.31	6.51	13.3

STATEMENT BY HON. HUBERT H. HUMPHREY, A UNITED STATES SENATOR FROM MINNESOTA

I deeply appreciate this opportunity to submit a statement to the Committee on Finance concerning H. R. 4473. This bill is of crucial importance to the defense effort and to the welfare of this country, and it is therefore essential that the soundest possible consideratino be given its provisions.

The citizens of this country are aware of the dangers that beset us. Communist aggression continues to threaten our security and the security of the free world. It can be halted in one of two ways. The first way is to stop the aggressor when he ventures to attack, as he was stopped in Korea. The second way is to arm ourselves and help build up the strength of our allies so that the aggressor will know that he cannot succeed. We must show our determination to protect freedom all over the world wherever it may be attacked.

The production program which is necessary to build the free world's defenses against communism is a large undertaking. It is expensive. It requires the diversion of a large proportion of our human and physical resources from production of peacetime goods to the production of arms and munitions. It means that we will temporarily have fewer automobiles, refrigerators, and television sets, and that our wage earners and farmers will have to work longer hours. Above all, it needs all the courage and foresight which is characteristic of the American people.

The genius of the American people to produce more in times of great stress is always underrated, but it has been proved many times. I believe we can achieve the production goals required to complete the military program and also to lay the groundwork for increasing living standards, not only in this country but also in the rest of the free world. We need only to harness some of the tremendous potentials which are still untapped here and abroad to realize these objectives. We will not succeed if we listen to the prophets of doom who for years have been underestimating the strength of our economy.

The cold war is not a temporary phenomenon. It is one of the practical political facts of our generation. In the present armistice talks in Korea, we are dealing with only one thrust of communism. Even though one thrust may be stopped, there is no telling when a second will strike in another corner of the globe. We will not cope with communism unless we face the cold, hard fact that we must build up our strength for a long pull. We cannot arm quickly to meet one threat and then disarm as soon as it has been averted. Such a course of action is wasteful and inefficient. More important, if we relax our guard even once, we are likely to lose the fight against the enemies of freedom.

The fact that the cold war is likely to last a long time makes it imperative that we plan ahead. Our economic system must be based on a strong foundation if we are to succeed in our resolve to stop communism. Part of this foundation must be a strong and equitable tax system which will be adequate to pay the cost of rearmament.

ECONOMIC POLICIES FOR DEFENSE

The production job which lies ahead of us is no more difficult nor more challenging than the job of keeping the economic system in balance. Inflation is as much a threat to our security from within as military aggression is from without. If we falter, inflation will reduce and distort production, destroy savings and will impoverish those who fall behind in the race between incomes and prices.

Control of inflation requires the full use of direct and indirect controls. We must control prices and wages, direct the flow of raw materials and allocate scarce and strategic metals. At the same time, we must keep a balanced budget, hold down credit, and stimulate savings. Both direct and indirect controls reenforce one another and must used simultaneously.

We must continue to rely on direct controls, but we cannot at the same time allow Federal expenditures to outstrip revenues. The result of continuing deficits is that the incomes of consumers and business will be substantially higher than the goods and services available for their use. The excess demand would quickly undermine effective price controls.

Although the program of direct and indirect controls which was in effect the first half of this year was much maligned by its opponents, the plain fact is that it worked effectively, once it was put into effect. Within 2 months after the price freeze, the price level was practically stabilized. Consumers' prices rose 1 percent per month from June 15, 1950, to February 15, 1951; they rose less than three-tenths of 1 percent per month between February and May and then fell in June. Wholesole prices rose 17 percent between June 15, 1950, to February 15, 1951; on July 15, 1951, they were 2 percent lower than in February.

This is no accident. The inflationary spiral was halted by taxes, credit controls, and price controls. The cessation of inflation in the last 2 months is a classic example of how effective the appropriate combination of direct and indirect controls can be.

The man on the street may not be familiar with the exact logic supporting a program of direct and indirect controls. Yet, he has consistently indicated his support for both. He knows that price controls are needed. He knows also that the Government cannot go on spending without levying the taxes needed to pay for it. His insistence on price controls, his acceptance of the higher tax burdens imposed shortly after Korea, and his demand for an excess-profits tax demonstrate that the Congress is not ahead of him in these matters. The intelligence he has displayed gives further proof of the basic strength of our democratic form of government.

GUIDING TAX PRINCIPLES

In facing the tax problem, we should be guided by these self-evident principles:

First, the total amount of revenue to be raised by any tax bill must be predicated on appropriations and authorizations made by the Congress. As yet, this is not a fixed sum since Congress has not yet completed action on authorizations or appropriations. It is clear, however, that substantial additional revenues will be needed to meet these obligations.

Second, in this extended period of mobilization and defense, it is imperative that we abide by the principle of pay as we go. Therefore, it is the responsibility of Congress to revise the tax structure and to increase the tax yield in accordance with congressional authorizations and appropriations.

Third, while tax rates may be subject to alterations to meet current revenue needs, the structural aspects of the basic tax law must be based upon principles of equity and ability to pay. In a period of high cost of living, in a period when American business enterprise is called upon to convert to defense production, in a period when workers' wages are controlled by wage-stabilization formulas, sound public policy and good conscience demand that the glaring loopholes and inequities in our tax structure be corrected.

THE NEED FOR HIGHER TAXES

The fiscal year which ended June 30, 1951, closed with a surplus of $3.5 billion. This surplus is due to the foresight of the Congress in increasing taxes during the latter half of 1950 and to the ability of the American economy to produce more than the most optimistic forecasts. Had we waited for a budget deficit to develop before taxes were increased, it would have been too late to repair the damage which an unbalanced budget would have done. No further proof is necessary of the wisdom of increasing tax revenues to balance a prospective budget than events in the past 6 months. We must continue to plan ahead.

During the early stages of a defense program it is difficult to determine precisely what our revenue requirements will be. It is nevertheless certain that at least during the coming 12 months the defense program will be building up rapidly. On the basis of current estimates by the Bureau of the Budget expenditures in this fiscal year will be $68.4 billion. If this total is realized, the annual rate of expenditures at the end of this fiscal year will be substantially higher, since we begin the present fiscal year with an annual rate of expenditures of something like $55 billion.

In making fiscal plans for the coming year, it is important to understand that present Government expenditures do not adequately reflect the prospective impact of the defense program on the economy. Total Government contracts already made run into the tens of billions of dollars. Work has already begun on many of these contracts and our resources are already being converted to defense production. Further price pressures are expected to materialize in the next few months as soon as curtailment of raw materials needed for defense purposes has its effect on the supply of goods. The inflationary potential which the defense program will generate when it is in high gear can have disastrous effects unless we are prepared to meet it with adequate fiscal measures.

We must not unduly delay enactment of this tax program. Every month that passes before the tax bill is enacted means that the revenues will be correspondingly reduced. Inflationary pressures are being generated by the Federal budget at this very moment—expenditures are already exceeding estimated receipts. In the month of July alone, there was a budget deficit of over $2 billion.

In his testimony before this committee, the Assistant Director of the Budget estimated that expenditures in fiscal year 1953 will be no less than $80 billion. Under these circumstances, we are likely to err on the low side rather than on the high side in making our tax plans for the future. It is unwise to try to trim the tax program precisely to get no more than a budget balance in the present fiscal year. A moderate budget surplus, if it is achieved, would be welcome. It would enable us to further reduce the public debt and thus to counteract the excess demand which will surely materialize as the defense program develops. Equally important, it will put us in a better position next year to face the full impact of inflationary pressures when Government expenditures will be substantially higher than they are today.

THE ESSENTIALS OF A SOUND AND FAIR TAX PROGRAM

I believe you will agree with me that the man on the street, however unsophisticated he may be, endorses a pay-as-we-go policy. He is willing to be taxed to pay for his own defense. But he insists that taxes be levied fairly, that everybody shoulder the burden according to his ability to pay.

I want to emphasize this point because I believe it is important. When we increase the tax burden of a married man with two children and with an income of $60 a week by $1 a week, we are denying him the use of a dollar which would otherwise go for food, clothing, or lodging. There is little room for anything else in his budget. This sacrifice can and will be borne by our wage earners and farmers if they are assured that others are paying their fair share.

We cannot in good faith ask the rank and file to make a substantially larger tax contribution for the defense effort when a chosen few can take advantage of glaring loopholes in the tax laws. It would violate every test of equal sacrifice to ask the man with low income to pay higher excise and income taxes when the rich become richer through our failure to close loopholes.

There are those who will argue that loophole-closing will not raise much revenue. This line of argument is familiar: why worry about a relatively small amount of revenue when billions are needed: substantial additional revenue can be raised only by raising rates. This is false counsel. Let there be no mistake about this: billions of dollars can be raised by plugging loopholes. If these loopholes are not plugged the required revenue must be raised from those less able to pay. Here are a few examples of these loopholes.

First, the unbelievably generous depletion provisions hand the oil and mining interests hundreds of millions of dollars each year. Last year, the President called this loophole the most glaring in the tax laws. Congress did nothing about it. This year with tax rates going still higher, this loophole is even more indefensible.

Second, the estate and gift taxes are in a pitiful state. It is unbelievable that, in a country as wealthy as ours, these taxes raise little more than three-quarters of a billion dollars. The Secretary of the Treasury presented a plan to the Congress last year for tightening up these taxes but nothing was done. The estate and gift taxes should be made to contribute substantially more than they do now. A tax bill of the size being considered here would be deficient without a thorough revision of these taxes.

Third, at the same time that wage earners are paying every last cent of their taxes because it is withheld from their pay envelopes, billions of dollars of interest and dividends are evading taxes. This critical evasion must be stopped. The best way to do this is to withhold the tax from interest and dividends just like we do on wages and salaries. The withholding provision for dividends and certain interest payments in this bill is a good start in this direction.

Fourth, the income-splitting provisions enacted by the Eightieth Congress confer unwarranted tax benefits on the well-to-do. People with incomes under $5,000 gained nothing from this provision and this includes 80 percent of all the taxpayers. At the $25,000 level, it reduces taxes of a married person by about $2,500; at the $200,000 level, it saved a married taxpayer about $25,000 in taxes. We cannot afford to give such large tax reductions to the higher income groups in times like these. Equally important, this type of tax favoritism is a violation of the principle of the ability to pay.

Aside from these four items there are many others, such as the loopholes in the excess-profits tax and in the capital-gains provisions, the tax exemption for interest on State and local government bonds, the weak tax provisions for life-insurance companies, and the tax hand-outs to the large corporations through accelerated amortization provisions which are now available for some six billion dollars of prospective plant expansion.

A determined effort to close all the loopholes could be made to yield billions more. I realize that the need for speed will preclude a complete study of all of these loopholes. Nonetheless, there is more than enough to choose from to raise the yield in the bill now before you without delaying it unnecessarily.

Since congressional action on appropriations is not yet completed, the exact amount needed for this bill is not known. However, there is every indication on the basis of the Bureau of the Budget estimates and the estimated requirements of the defense program, that the prospective yield of the House bill will prove to be insufficient to balance the budget. In that case, the deficiency can be made up by closing the loopholes that I have described. If, on the other hand, the revenue yield of the House bill proves to be adequate, the percentage increases in tax rates on individuals and corporations can be substantially reduced by a concerted effort to close these loopholes.

ANALYSIS OF H. R. 4878

According to the estimates of the Joint Committee on Internal Revenue Taxation, the $7.2 billion of additional revenue which would be collected in a full year of operation under H. R. 4473 would be obtained from the following sources: $2,847 million from changes in the individual income tax; $2,855 million from changes in corporation income and excess profits taxes; $1,252 million from increases and revisions in the excise taxes and a net increase of $245 million from structural changes.

The bill as it now stands has three major defects:

First, as I have already indicated, the revenue yield may be too low. It will not balance the budget in fiscal year 1952 at prospective levels of expenditures and will moreover probably fail to strengthen the tax system efficiently to do the job it will be required to do before the fiscal year is over.

Second, although the structural changes in the bill show a net increase in revenues of almost a quarter of a billion dollars, this net figure covers up the fact that the House bill introduces several important new loopholes. By reference to the detailed table on pages 62 through 65 of the report of the Ways and Means Committee on the bill, you will find a number of important large tax reduction items which are unwarranted. In total, the admitted cost of these provisions, which I shall enumerate later, is $153 million and the actual cost will undoubtedly be much greater. This tax bill must be rid of such flagrant attempts to distort the tax laws in favor of a chosen few.

The third deficiency of the tax bill is that it does not close enough loopholes. There are a number of desirable revisions in the bill, including the new withholding provision for dividends, interest and royalties, the elimination of the two for one offset of short-term capital losses against long-term capital gains and the denial of multiple surtax exemptions and excess profits credits resulting from corporate split-ups. These provisions should be retained but the scope of tax revision should be substantially expanded.

Individual income tax

Perhaps the most equitable feature of the entire bill is the defense tax which increases all present taxes by 12½ percent. Nonetheless, it has been criticized severely, mainly by the same people who object to closing loopholes.

We can dispose of the first criticism quite easily. It is said that the 12½-percent increase in tax liabilities is confiscatory and that it is too burdensome on the rich. There can be no doubt that this portion of the bill calls for the rich to make a real contribution to the defense effort. This is exactly why I consider this measure to be equitable and desirable. For a married person with two dependents, the defense tax would reduce spendable income by 2.3 percent at the $5,000 net-income level, 3.6 percent at the $10,000 level, 4.8 percent at the $25,000 level and 8.1 percent at the $100,000 level. The charge of confiscation cannot be taken seriously, since the $100,000 taxpayer will have $41,600 left after taxes even after the increase provided by this bill, and without taking into account the many opportunities for tax avoidance which are available to the $100,000 taxpayer.

The argument against the 12½-percent increase which is to be given more serious consideration is that there are other means of raising $3 billion in the framework of the individual income tax which would more effectively relieve inflationary pressures. It is theoretically true that, potentially, a dollar in the hands of a person who needs that dollar for everyday expenditures is more inflationary than a dollar in the hands of those who are fortunate enough to save part of their income. However, I feel strongly, and I am convinced that the majority of the American people share this feeling, that taxable individuals in the lowest brackets are already contributing more than their fair share of the total tax burden.

The staff of the Joint Committee on the Economic Report recently published the latest study of the distribution of total Federal, State, and local taxes by income levels. These figures are no less than startling and it is unfortunate that they have not been given more widespread publicity. The facts are that, in 1948, individuals and families with incomes under $1,000 paid 23.6 percent of their income in taxes to all levels of government. This compares with 20.8 percent between $1,000 and $2,000; almost 22 percent between $2,000 and $5,000; 23.1 percent between $5,000 and $7,500; and 31.7 in the classes above $7,500. Thus, the people with incomes below $1,000 actually bear a heavier tax load, when all taxes are taken into account, than any group up to the $7,500 level.

The brunt of the recent rise in prices fell on those people who can barely make ends meet. In the light of the facts I have just mentioned, it would be cruel to require low-income people to pay a disproportionate share of the additional tax load needed for defense. I submit that the need to impose taxes to help control inflation should not be used as an excuse for the adoption of oppressive increases in income taxes or some form of sales taxation which would weigh less heavily on wealthy individuals who can contribute to the national effort without suffering any hardship.

It is well to recall, in this connection, that persons in the middle and higher-income brackets derive the largest benefits from the preferential treatment granted married persons in the Revenue Act of 1948. The income-splitting provision, which was adopted at that time to equalize tax burdens of married persons in all States, created serious inequalities in the tax treatment of single persons and married persons. H. R. 4473 not only does not remove these inequalities but actually increases the tax differential between single persons and married persons by the same 12½ percent by which all rates are increased.

The Ways and Means Committee was well aware of these inequalities and felt it necessary to extend half of the advantage of income splitting to single persons who are "heads of households." A "head of household" is defined in H. R. 4473 as single persons who maintain in their household children or their descendants whether or not they can support themselves or who maintain any relative for whom they claim an exemption under present law. The line between single persons who do and who do not qualify as heads of households is not sharply drawn by this definition. Considerable litigation will result and there is grave danger that eventually the principle of income-splitting with its regressive effects will be extended to all single persons.

Income-splitting reduced the effectiveness of rate graduation in the individual income tax and consequently increased the relative tax burden of the lower income classes, particularly those whose surtax net income is below $2,000. Extending this privilege or parts thereof to heads of households further reduces the effectiveness of rate graduation and does so precisely at a time when the burdens of all other taxpayers are being increased in the interest of the defense effort. It is my conviction that the reduction of the differential in tax liabilities between married persons and single persons should be reduced not by extending the regressive feature of income splitting to a new category of taxpayers but on the contrary by eliminating this privilege in the case of married persons.

I suggest that the head-of-household provision be removed from the bill and that the bill be revised so as to remove the advantage of income-splitting for all married persons. This can be done without destroying the equality of tax treatment for married persons in all States and without peopardizing the operation of local property laws. It would mainly affect married couples whose surtax net income is in excess of $10,000. It would not alter the tax liabilities of married persons in the first surtax net income bracket and would increase the liabilities of married couples under $10,000 by relatively small amounts. The revenue to be gained from this revision amounts to about $2.8 billion under the rates provided by the bill.

Corporation taxes

The bill raises corporation income and excess profits taxes by a total of $2.8 billion in a full year. This increase is justified on the basis of the large increases in profits which corporations have experienced. For the entire year 1951, the Joint Committee on Internal Revenue Taxation estimates that corporation profits will amount to $20 billion after the taxes imposed by this bill. This compares with average profits after taxes in the three best years of the base period 1946–49 of $18.8 billion. Even though corporations are subject to an excess profits tax on earnings in excess of 85 percent of average base period earnings, it is now clear that relief provisions which greatly enlarge the concept of normal earnings operate to exempt a large portion of excess profits from special taxation.

It has been contended that the tax increase imposed by the House bill which becomes effective on January 1 of this year is retroactive. Except for the increased corporation income taxes adopted last year, changes in corporation tax rates have ordinarily been made effective beginning in the calendar year during which the legislation was enacted. I consider the departure last year as having been unwarranted. This year, deferment of the corporation income tax increase until after the bill is enacted would free the corporations from increased tax burdens on their record profits. Profits in the first half of the year will run at an average annual rate of close to $50 billion before taxes and after taxes they will probably average $23 billion. These are high profits by any standard and are properly subject to higher taxes. The argument that increased corporation taxes made effective the first of the year are retroactive is merely a pretense to enable corporations to escape their fair share of this year's tax burden.

Undesirable provisions in the bill

As I have indicated, there are a number of technical provisions which have been inserted in the bill in the name of tax revision, but which provide substantial and unwarranted tax reduction. It is unconscionable to impose $3 billion of taxes on ordinary individual incomes and at the same time to allow a few to have very substantial tax reductions.

The provisions I refer to are the extension of percentage depletion to a large number of minerals at a cost of $67 million; the double deduction granted to development costs in mining at a cost of $20 million; the extension of capital gains treatment to coal royalties at a cost of $10 million; and the head-of-household provision, which I have already discussed, at a cost of $50 million. Finally, the provision on family partnerships, which was eliminated in the Revenue Act of 1950, is back again to plague us. The Committee on Ways and Means did not estimate the revenue loss from this provision but it will certainly run into millions of dollars.

I believe it is desirable to examine only one of these provisions to illustrate how thin the justification for the relief is in these cases. On the subject of coal royalties, for example, the Committee on Ways and Means stated that coal royalties should be treated as capital gains because lessors of coal property have not, it is claimed, received price adjustments for royalty contracts made in the past and that some of them cannot benefit from percentage depletion even under the generous terms of present law. To compensate such individuals for these great "hardships" the tax law singles them out and grants them capital-gains treatment. This is no more unfair than if we were to grant capital-gains treatment to interest on bonds issued before January 1, 1951, on the ground that the interest rate is fixed by contract and is not adjusted for price increases. There is absolutely no justification for such discriminatory provisions and they should be eliminated from this bill.

I need not dwell at great length on the family partnership provision which was discussed in full on the Senate floor in connection with the Revenue Act of 1950. This provision is the same as that in the Senate version in the Revenue Act of 1950 which was eliminated by the House and Senate conferees.

There is no question that this family partnership provision opens up a very substantial new loophole. Far from simplifying the law this provision will multiply and codify a number of existing complications. It literally invites every owner of a moderately successful business to split his business income with his children and other relatives by granting them an interest in the business through a gift of capital. The report of the Ways and Means Committee justifies the provision on the ground that it is intended to clarify the law. But it is really intended as an announcement to all individuals that for the relatively minor cost of changing their business from a sole proprietorship to an artificial partnership it will be possible to split their incomes several ways for tax purposes.

Combined with the elimination of the advantage of income splitting for all married people, removal of the provisions which I have enumerated would add a total of almost $3 billion of revenue to the bill.

PROPOSED LOOPHOLE CLOSING PROVISIONS

Percentage depletion

The first and most important loophole which should be closed is the percentage depletion loophole. At present rates and income levels, percentage depletion saves oil and mining interests at least three quarters of a billion dollars a year. Such a tax relief cannot be justified either on equity grounds or on economic grounds.

The Secretary of the Treasury has discussed with your committee and the Committee on Ways and Means the nature of this loophole and has presented some astounding figures as to how big it really is. He also outlined to you in some detail, during the hearings on the Revenue Act of 1950, the adjustments which can be made as a first step toward eliminating this loophole. His proposal was to reduce percentage depletion for oil, gas, and sulfur to 15 percent of gross income and for nonmetallic minerals to 5 percent. He also proposed that oil and gas operators who elect to deduct as expense intangible drilling and development costs be required to reduce income from the property by the amount of such expended costs in computing their depletion allowance. These changes would increase revenues by $300 million. If adopted, they would eliminate the excuse for extending percentage depletion to other minerals, as the House bill does. So long as these provisions remain unchanged, it will be difficult to withstand the pressure to enlarge the list of minerals allowed percentage depletion.

Estate and gift taxes

Except for the estate- and gift-splitting provisions which were enacted in 1948, the estate and gift taxes have remained untouched since 1942. The opportunities to avoid high transfer taxes either by placing property in trust or making gifts still remain open for those who have skilled legal counsel. The 1948 provisions, moreover, undercut substantially the effectiveness of the already weakened rate structures of these taxes. In their present state, the transfer taxes are no more than a mere appendage of the tax system and do not accomplish either the equity objective for which they were designed or raise sufficient revenue in a defense period.

The Secretary of the Treasury has given to your committee a detailed account of the loopholes in this area and has also recommended specific measures that might be adopted to strengthen them. He suggested that exemptions be reduced and that rates be increased. I would add to this that the estate- and gift-splitting provisions should be repealed. At least $700 million of additional revenue can easily be raised from these revisions. This would increase the total yield of the estate and gift taxes to almost $1½ billion, an amount which would not be unduly burdensome in view of our requirements for additional revenue.

Capital gains

The capital-gain rate is now limited to a maximum of 25 percent, and profits from the sale of assets held for 6 months or more are given this preferential treatment. So far as I have been able to determine, the 6-month holding period accomplishes nothing except to reduce the taxes of speculators who are able in one way or another to hold their gains for at least 6 months in order to obtain the preferential rate on long-term capital gains.

The low rate of tax on capital gains singles out for special treatment incomes which are no less evidence of ability to pay than other types of incomes. Moreover, capital gains are a high proportion of income in the highest brackets and the preferential treatment accorded them is, therefore, especially favorable to the wealthy.

The logic presented by the Secretary of the Treasury seems to be appropriate for correcting this deficiency in the tax bill. He pointed out in his statement to you that the starting rate on ordinary incomes and the rate on long-term capital gains for individuals not subject to the alternative tax were increased substantially under the Revenue Act of 1950 and will also be increased again under this bill. The adjustment in the rate in the alternative tax should be increased correspondingly.

Another adjustment in capital-gains provisions which should now be made is the elimination of sections 117 (j) and (k). Section 117 (j) is the "one-way street" which gives individuals and corporations the opportunity to be taxed at capital-gains rates on profits from the sale of depreciable property, but allows them to deduct losses on such property in full. Section 117 (k) gives capital-gains treatment to timber, and under the bill it is expanded to coal royalties.

Lengthening the holding period, an increase in the alternative tax rate commensurate with the increases in the starting rate on ordinary incomes since Korea, and repeal of sections 117 (j) and (k) would raise the revenue from capital gains by an additional $400 million.

I have reviewed fairly extensively the provisions of the House bill in order to indicate how they can be revised and strengthened to yield sufficient revenue for our pay-as-we-go policy. Most of my suggestions involve eliminating loopholes which have crept into this bill and old loopholes which still remain in the law. Loophole closing is not an easy undertaking since it will raise opposition by powerful interests. Unfortunately, the man on the street does not have a lobby to protest the injustices in our tax laws, he must be protected nonetheless.

We are all committed to a pay-as-we-go policy. It is essential to the continued success of the defense program. It is our duty and responsibility to the people to see to it that increases in their taxes are accompanied by reductions in the unwarranted relief provisions of the present tax laws. Your colleagues in the Senate are relying heavily on this committee to report to them a tax bill which meets these requirements.

BETHESDA, MD., *August 7, 1951.*

Hon. WALTER F. GEORGE,
Chairman, United States Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: With reference to the Revenue Act of 1951 (H. R. 4473), particularly section 303 thereof, amending "the present provisions relating to a gain on the sale of a taxpayer's principal residence so as to eliminate a hardship under existing law which provides that when a personal residence is sold at a gain the difference between its adjusted basis and the sale price is taxed as a capital gain":

According to the report of the Committee on Ways and Means, House of Representatives, accompanying H. R. 4473, "the hardship is accentuated when the transactions are necessitated by such facts as an increase in the size of the family or a change in the place of the taxpayer's employment." The writer comes within the first category of an increase in the size of family by virtue of having had to purchase a new home of larger size and facilities in order to provide quarters for a married daughter and two small grandchildren due to the fact that my son-in-law had to leave the country for foreign service with the United States Air Force.

It was therefore necessary for me to acquire a larger and more costly home in July 1950, but, in view of the existing capital-gains tax, it was felt that the most prudent procedure at that time was for me to make a down payment on the new home, and assume a mortgage for the balance due, and to rent my former residence rather than to sell it and apply the proceeds therefrom on the new home.

Section 303 of the bill proposes that "when the sale of the taxpayer's principal residence is followed within a period of 1 year by the purchase of a substitute, or when the substitute is purchased within a year prior to the sale of the taxpayer's principal residence, gain shall be recognized only to the extent that the selling price of the old residence exceeds the cost of the new one."

As will be seen under the proposed law, I do not believe I could qualify for the benefits held out to these taxpayers because my new home will have been purchased more than 1 year prior to the sale of the former residence. However, as every home owner knows too well, unless one can afford to pay the full cash purchase price for the substitute home, a mortgage must be assumed and while, technically, you have thus purchased a new home, you are certainly far from owning it until the mortgage is paid.

Under the circumstance, then, it is believed that the hardships mentioned would be more apt to be relieved if this section was so amended in those cases of involuntary conversion as to provide that if the home owner sold his old residence, say, at any time within 3 to 5 years (or whatever period seems right, but certainly more than 1 year) after the purchase of a new home, and applied the funds received from such sale toward the payment of the mortgage assumed on the new residence, that any gain within the limitations enumerated in section 303 should not be taxed as a capital gain.

It would seem that the present provisions of section 303 are too restrictive to alleviate the hardships mentioned and that just a slight change in the provisions referred to is necessary in order to help the taxpayers mentioned.

Your earnest and favorable consideration of the subject will be more than appreciated by many home owners caught in the predicaments mentioned.

Yours very truly,

CLARENCE I. POORE.

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
August 10, 1951.

Senator WALTER F. GEORGE,
Chairman, Committee on Finance,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: This will refer to a memorandum filed with you for the committee by L. O. Monroe on behalf of the National Association of Fan Manufacturers regarding a clarifying amendment to section 484 of H. R. 4473.

Mr. Monroe has proposed a clarification to specifically designate the recognized types of fans for household use which would be subject to tax. If the committee should reject that amendment, may I respectfully suggest that it incorporate in its report language which will be a part of the legislative history and which will more clearly designate the types of fans which are subject to tax. This, of course, is on the assumption that there will be a provision for some such tax.

The desirability for incorporating such language revolves about the apparent intent of the House as revealed in its report, page 46, to apply the tax on "fans of the household type" which is in conflict with the Treasury Department's application of section 3406 (a) (3) of the Internal Revenue Code regarding "electric direct motor-driven fans" which has been extended far beyond fans for household use to what are essentially industrial machinery products otherwise exempt from an excise tax.

With best wishes, I am
Yours sincerely,

HOMER FERGUSON.

NATIONAL ASSOCIATION OF FAN MANUFACTURERS, INC.,
Detroit 26, Mich., August 13, 1951.

Re proposed clarifying amendment to section 484 (p. 188), H. R. 4473, Revenue Act of 1951.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.:

Supplementing memorandum of August 1, 1951, find attached a chart bearing on the above subject. The chart attempts to show graphically basic types of fans, specific types of fans, functions and other pertinent data. It is presented in the hopes of simplifying the technical points on fans and to help in reaching an understanding of the problem.

When "electric direct motor-driven fans" were first included in the list submitted by the Treasury Department to the Congress for excise purposes in 1941, Mr. John L. Sullivan, Assistant Secretary of the Treasury said, "We have selected certain luxury articles which though widely used are not necessities" (p. 50, vol. 1, 1941, Ways and Means Committee).

On the same subject of items, before the Committee on Finance, Secretary Morgenthau said, "That list has been carefully selected from the point of view of articles which would compete with our national defense, or articles which are considered luxuries at this time" (p. 24, Committee on Finance, August 8, 1941).

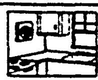
A further search of the records has not revealed that either the Congress or the Treasury Department has ever advocated an excise tax on industrial machinery products. There is, therefore, no justification, either in the past or now, for imposing an excise tax on industrial types of fans.

We raise no objections to a tax on fans in the luxury class or for household use. Our objection is to the extension of the tax on industrial fans either by law or by subsequent ruling of the Treasury.

May we respectfully ask for your approval of the proposal outlined in our memorandum of August 1, 1951.

L. O. MONROE, *Secretary.*

CHART OF BASIC AND SPECIFIC TYPES OF FANS-REFERENCE BULLETIN Nº108 NATIONAL ASSOCIATION OF FAN MANUFACTURERS
(SECTION 484 H.R. 4473, PAGE 138, REVENUE ACT 1951 TO AMEND SECTION 3406 (a) (3) OF THE INTERNAL REVENUE CODE)

BASIC TYPES	SPECIFIC TYPES	FUNCTION	TAX STATUS	SALES 1950	REMARKS
ELECTRIC FANS	 WALL OR BRACKET FAN	FOR HOUSEHOLD AND OFFICE USE (DIRECT MOTOR DRIVEN ONLY)	SUBJECT TO TAX	NOT DISTRIBUTED TO THE PUBLIC. STATISTICS COLLECTED BY NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION	PROPOSED CLARIFYING AMENDMENT AS RECOMMENDED IN LETTER AUGUST 1, 1951 TO HONORABLE WALTER F GEORGE, CHAIRMAN, COMMITTEE ON FINANCE, UNITED STATES SENATE: "ELECTRIC DIRECT MOTOR-DRIVEN FANS OF THE CEILING, WALL BRACKET, DESK, PEDESTAL AND AIR CIRCULATOR TYPES AND THOSE TYPES OF PROPELLER FANS FOR HOUSEHOLD USE ONLY, COMMONLY CALLED KITCHEN, WINDOW AND ATTIC FANS, BOTH DIRECT MOTOR-DRIVEN AND BELT DRIVE;"
	 DESK FAN				
	 AIR CIRCULATOR OR PEDESTAL				
	 CEILING FAN				
PROPELLER FANS	 KITCHEN FAN	FOR HOUSEHOLD USE (EITHER BELT DRIVE OR DIRECT MOTOR DRIVEN)	SUBJECT TO TAX	$66\frac{2}{3}$% *	
	 WINDOW FAN				
	 ATTIC FAN				
	 INDUSTRIAL FAN	INDUSTRIAL PLANTS, SHIPBOARD, FARMS, INSTITUTIONS, MINES, POWER PLANTS	QUESTIONABLE	$33\frac{1}{3}$% *	THE CONGRESS HAS GIVEN NO INDICATION THAT EITHER A SALES OR AN EXCISE TAX IS TO BE APPLIED ON MACHINERY PRODUCTS. TO SINGLE OUT INDUSTRIAL FANS FOR TAX PURPOSES IS UNFAIR AND DISCRIMINATORY IN COMPARISON WITH OTHER INDUSTRIAL PRODUCTS, WHETHER DONE EITHER BY LAW OR RULING.

*TOTAL PROPELLER FAN SALES IN 1950 WERE $22,300,000

PREPARED BY
NATIONAL ASSOCIATION OF FAN MANUFACTURERS
[illegible] GUARDIAN BUILDING DETROIT [illegible] MICHIGAN

UNITED STATES SENATE,
COMMITTEE ON AGRICULTURE AND FORESTRY,
August 7, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: I should like to call to your attention a matter which I believe deserves the consideration of your committee, in connection with its consideration of the revenue bill, H. R. 4473.

Certain of my constituents are owners of so-called claw or digger machines, which are placed in retail establishments in New Orleans. I understand that such machines are also operated elsewhere on a small scale. On August 3 of this year there was testimony before your committee by a representative of Baltimore owners of claw machines.

These machines are classified by the Bureau of Internal Revenue in the same category as the so-called one-armed bandit, under section 3267 of the Internal Revenue Code. As such they are now subject to the slot machine tax of $150, which would be increased to $250 under H. R. 4473.

The information made available to me indicates that the claw machine is not a gambling device in the nature of the "one-armed bandit" and should therefore be placed in a different classification for purposes of the special tax levied under section 3267. The claw machine owners feel that the competent officers of the Bureau of Internal Revenue would be sympathetic to a reclassification which would be more suitable to the character of the machines and the modest resources of the owners. I am informed that even with the present $150 levy the owners of the machines will be forced out of business, as indeed many already have.

It is my hope that you find it possible to request Mr. Colin Stam to examine this matter and to ascertain the attitude of the Treasury Department toward a reclassification of these machines.

With kindest regards, I am

Sincerely,

ALLEN J. ELLENDER,
United States Senator.

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
August 7, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: It has come to my attention that one of the provisions of H. R. 4473, now under consideration by your committee, may do much more harm than good.

Section 123, regarding surtax exemptions and certain credits of related corporations, should be stricken from the act unless it can be rewritten so as to exclude bona fide multiple-corporation structures which are not created merely to avoid taxes.

It seems highly unfair to me to double the existing tax rates on many small businesses in an attempt to close a loophole in the law that may have worked to the advantage of a few chronic tax avoiders. This provision ignores the maxim of tax equity that a business should be taxed on its own profits. It works a severe hardship on an honest person who has more than one interest.

I cannot believe that this result is the intention of the Treasury Department or of the Congress. Sections 45 and 120 of the existing Internal Revenue Act appear adequate to control multiple corporate structures which are developed to avoid taxes.

I trust that your Finance Committee will recall the action it took in 1943 when it limited the impact of section 120 to artificial corporate divisions. Such a limitation is imperative in the case of the proposed section 123 unless your committee can see fit to eliminate it entirely.

My kindest personal regards and best wishes.

Sincerely,

PAT MCCARRAN.

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
August 8, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: I have been interested in the urgent need for elimination of the tax on admissions and the tax on cabarets, roof gardens, etc., for several years.

The present 20-percent tax on cabarets, roof gardens, etc., is nothing more than a nuisance tax. It is unfair to the hotel industry, and places an undue burden on both the entertainer and the entertainment seeker.

There can be no question that this tax has hurt the hotel business to a considerable extent. For the information of your committee, I offer a tabulation of cabaret tax receipts since 1941 as reported by the Commissioner of Internal Revenue:

Cabaret tax payments

	Percent	Amount		Percent	Amount
Fiscal year ending June 30—			Fiscal year ending June 30—Continued		
1941	4	$2,343,310.00	1947	20	$63,349,838.00
1942	5	7,399,542.00	1948	20	53,527,145.00
1943	5	16,396,829.00	1949	20	48,850,069.00
1944	30	26,726,311.00	1950	20	41,453,394.00
1945	20	56,877,239.00	1951	20	[1] 42,646,313.70
1946	20	72,076,898.00			

[1] Preliminary.

It is noteworthy that receipts from this tax have been declining since 1946. There are two major reasons for this decline in receipts. One of them it the mounting resistance by the public to paying for entertainment when the tax is applicable; the other is the fact that hundreds of entertainment rooms have been closed in hotels because this tax is too onerous to bear.

The effect of the tax on employment can easily be seen by a quick perusal of the statistics relating to unemployed entertainers.

Section 404 (a) of H. R. 4473 seems to further confuse the already difficult-to administer cabaret provision. I believe that this tax should be eliminated entirely. To do so would require amendment to both section 1650 of the Internal Revenue Code by striking out, in the table contained in such section, the matter relating to cabarets, roof gardens, etc.; and also the repeal of section 1700 (e) of the Internal Revenue Code, relating to the admissions tax on cabarets, roof gardens, etc.

Sections 401 and 402 of H. R. 4473 are steps toward elimination of the tax on admissions, but they do not go far enough. Some of the provisions of these sections may result in inequity. If a movie-goer's entertainment should be taxed, then why should not admissions to a cooperative or community center moving-picture theater be taxed? If a swimmer it to be taxed for swimming, then why not for swimming in a municipal pool where admission is charged? There are other, and equally absurd, contradictions in the admissions tax proposal. The simplest solution, and the solution which I urge upon your committee, is that this tax be abolished.

My kindest regards and best wishes.

Sincerely,

PAT MCCARRAN.

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
August 8, 1951.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: It has come to my attention that the additional revenue to be derived from manufacturers' excises under H. R. 4473 is composed 110 percent of increase in taxes on highway users. This increase of $533 million will work a particular hardship on both automobile owners and truckers in the West.

The day has passed when an automobile could be considered a luxury. In my part of this country it is an absolute necessity. It is a necessity for hundreds of thousands of American families and the increased tax on automobiles, parts, and accessories increases the cost of keeping the family car running.

For commercial users, in most instances, these new taxes will have to be regarded as costs of production, and consequently passed on to the consumer in higher prices. However, for private owners of motor vehicles the tax is direct; that is, it rests on the payer and cannot be passed on. These taxes will make a considerable draft upon persons of small income. The higher prices occasioned by the additional taxes, coupled with current credit restrictions, will make it impossible for the workingman to replace his now-aged jalopy. That is particularly the case when it is added to the cost of a license, property, and other taxes which fall upon the owner of a car.

These taxes are, in large part, regressive and bear much more heavily on a man with small means than on one who has a more flexible and remunerative source of income. Our unbalanced tax structure has no more room for additional taxes of this sort.

It is my sincere hope that your committee sees fit to eliminate the increases in these excises.

My kindest personal regards and best wishes.

Sincerely,

PAT MCCARRAN.

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, D. C., August 9, 1951.

Senator WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR SENATOR: I am writing to request the Senate Finance Committee's earnest consideration of the attached proposed amendment to H. R. 4473, and I am outlining below the reasons for this request.

In Birmingham, Ala., each year a benefit football game is played between two of the State's outstanding high-school teams, and all proceeds from the game go to the crippled children's clinic. We have in Birmingham one of the most modern hospitals for crippled children in the entire country, and it is proving a difficult task to provide funds to operate the hospital for the benefit of crippled children of the State. A large part of the operating funds each year come from the benefit football game mentioned above.

No expense is attached to the game except the Federal admissions tax. Everything is donated. The Quarterback Club and members of the Birmingham Police Department sell the tickets. No charge is made by the city for use of Legion Field, and the officials donate their services. The Federal admissions tax last year amounted to approximately $7,500. This amount would have paid for the cost of 1,000 patient days in the hospital.

Under the circumstances, I very much hope that favorable consideration may be accorded the proposed amendment attached, or other change in the language of section 402 (b) so as to exempt this type of benefit event from payment of the Federal admissions tax.

Thanking you, and with kindest personal regards, I am,

Very sincerely,

LISTER HILL.

(H. R. 4473)

REVENUE BILL OF 1951

Paragraph (2) of bill section 402 (b) should be amended to read as follows:

"(2) NONEXEMPT ADMISSIONS.—The exemption provided under paragraph (1) shall not apply in the case of admissions to (A) any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary school, secondary school *or purely religious or charitable institution*, (B) wrestling matches, prize fights, or boxing, sparring, or other pugilistic matches or exhibitions, or (C) carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation."

STATEMENT OF ALLEN B. DU MONT, PRESIDENT, ALLEN B. DU MONT LABORATORIES, INC., CLIFTON, N. J.

I am conscious of your responsibility to produce a revenue measure adequate to our Government's needs in a time of emergency. It is my hope, therefore, that our carefully considered position and suggestions will be helpful in the production of that revenue while at the same time preserving the well-being of an important revenue source.

You will recall that during the last session Congress imposed an excise tax on television for the first time. The Secretary of the Treasury now has proposed an increase in this tax from 10 to 25 percent one of the sources of additional revenue "from excise taxes on those consumer goods which are less essential and which use materials that will be in short supply."

Since it is revenue you seek, we propose that better results can be obtained by rejecting the Secretary's recommendation for an increase in the excise levies and by eliminating the present levy on television.

We suggest that the Government Treasury would profit more by the elimination of a levy, rather than by the imposition of one.

While both radios and television receivers have many of the same components and are marketed by the same dealers and distributors, the proposition of a tax on television is quite different from a tax on radio.

In television we have a striking example of the law of diminishing returns at work. For the year 1950, television was a lucrative source of corporate income and excess-profits taxes. It was a lucrative source of individual income taxes deriving from full employment and profitable operations of an expanding distribution system.

In 1951, we see the situation reversed, with a 10-percent excise tax as one of the important contributing factors.

Warehouses are bulging with unsold television sets—unproductive and unprofitable to manufacturers, distributors, dealers, or the Government.

Elimination of the causes of this condition will be more productive of revenue than will aggravation of the condition.

Television is in its infancy. While its tremendous potential of public service as the most vital means of communication has been recognized in some quarters, it has been a victim of cross-purpose governmental policies before it has had a chance to fully develop or achieve national coverage.

On one hand, we find the Federal Communications Commission, the Senate Interstate and Foreign Commerce Committee, civil defense agencies, and even the Armed Forces dealing with television as a great national resource and planning full development and use of its potential.

On the other hand, we are confronted here with the recommendation of another department of the same Government which relegates this great national resource to the category of "less essential," in the same grouping as ordinary household appliances, and with hamstrings to prevent attainment of its great public usefulness. We might repeat, also, for emphasis, without the virtue of being a more productive revenue source.

Television in its present state of development and lack of national coverage is an entirely different creature than that you may have to consider if you permit it to grow and expand and fulfill its destiny.

In its present state, it is truly in a precarious position. Inventories are at an all-time high despite constantly decreasing production. Production for the week ending November 3, 1950 (the week the excise tax took effect) was 218,000. For the last week in June 1951, it was 27,000 and the following week it was 13,000. Despite the continual production decreases, factory inventories have risen steadily from 53,000 on November 3 to 740,000 on July 6, each week seeing an increase.

A situation just as bad, if not worse, exists with dealers.

The bankruptcy rate among dealers has risen rapidly and threatens to go even higher. Dealers, generally, do not have the capital to hold large inventories or to afford losses on conversion of inventory to cash to meet payrolls, rent, and other ordinary expenses. In that way, another source of Government revenue is being dried up.

At this point, it is not a case of needing curbs on production to release materials for defense. The industry is not even close to using its allowables, and materials already have been converted to inventory serving no healthy purpose.

This is not just a case of relief for a suffering industry. It calls for relief, sure, as a matter of good economics but what is important from the standpoint of revenue, it calls for constructive action to prevent revenue sterility of components of the industry. We contend that constructive action would consist of removal of the 10-percent excise levy and would result in greater benefits to the Treasury and to accomplishment of policy aims of other Government interests.

THE AMERICAN JERSEY CATTLE CLUB,
COLUMBUS, OHIO, *August 7, 1951.*

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: We are writing on behalf of 80,000 Jersey dairy farmers, many of whom have been harassed by the conflict between the regulations and rulings of the Bureau of Internal Revenue and the judgments and opinions of the courts (including the Tax Court) in the application of section 117 (j) (1) of the Revenue Code as it relates to the sale of dairy cattle. The proposed amendment in the bill (H. R. 4473) now before your committee will not, in our opinion, contribute to clarify the conflict but will serve to generate more confusion, problems, and litigation, the cost of which will mean hardship for thousands of small dairy farmers throughout the country.

We urge you to take into consideration that the primary business of the dairy farmer is the production and sale of milk and dairy products and, as a necessary incident of which, he must either buy or breed dairy animals to maintain his herd and its production to conform to the varying market for his product on the one hand and his ability to maintain (produce feed for) his herd, neither of which is within his control. In other words, to survive he must keep his operation in balance with the two controlling elements above referred to. This was ably treated and made clear by Judge Riddick of the Eighth United States Circuit Court of Appeals in the Albright case (173 Fed. 2d 339). In relation to this problem, we do not believe that there is any parallel in industry to the dairy farmer. The nearest comparison might be said to be a manufacturer who, for lack of a market for his product, a labor shortage, or other cause, finds it necessary to discontinue the operation of a portion of his production machinery. In such a situation he can do so and leave them idle at a cost of his depreciation, or he can sell the unused, and then surplus, machines, in which case, if he realizes a profit, no one, in or out of the Bureau of Internal Revenue, would question the fact that the transaction constituted the sale of capital assets and any gain was therefore taxable as a long-term capital gain.

The situation of the dairy farmer with reference to a lost or lagging market for his product is the same except that if he does not sell, he must maintain and feed (what to him is) his "production machinery" and manifestly constituting a capital asset. It is clear that in such a situation a dairy farmer could not long survive.

It must also be recognized and taken into consideration that no dairyman, though well qualified and efficient, can either control or foresee the results of the forces and uncertainties of nature. While great progress is being made in the science of breeding and breeding control and also the control of disease, the uncertainties involved in any breeding schedule or program and the ravages of disease place the dairyman in a situation where he must be able to control his capital investment in his "production machinery" (dairy animals) by the sale, when necessary or economically advisable, of his surplus cattle on a taxable par with other producers of commodities for sale.

In lieu of the proposed amendment we suggest, and urge for your consideration, the following:

"Such term also includes draft, breeding, or dairy livestock held by the taxpayer for 12 months or more, which livestock was not produced or acquired primarily for sale by the taxpayer."

In advocating the adoption of this amendment, we are asking for no special privilege, only that which appears to be fair, just, and equal treatment, at the cost of little and diminishing revenue to the Government but of tremendous importance to the future of dairy farming throughout the country.

Respectfully submitted.

THE AMERICAN JERSEY CATTLE CLUB,
FLOYD JOHNSTON, *Executive Secretary.*

MASSACHUSETTS SOCIAL SECURITY ASSOCIATION, INC.,
Framingham, Mass., July 21, 1951.

Senator WALTER GEORGE,
Chairman, Senate Committee on Finance,
Washington, D. C.

DEAR SENATOR: The writer called at the office of your committee last week and was informed that information suggested by him would be given consideration by your committee.

Accordingly, the writer respectfully submits for the consideration of your committee the following record:

Exhibit A.—Comparison of the operation of the Boston Federal Reserve Bank with the Bank of Canada showing that the Boston Federal Reserve Bank, doing about the same amount of business so far as providing money in each case about $1,400 million of currency outstanding, makes a loss compared with Canada of $121 millions a year besides the loss in local and States taxes of any revenue from taxation that would run to the State and cities and towns.

On that basis our Federal Reserve System is so bad that the cost to the people of this country is more than 3 billions a year besides putting in the control of private bankers the monopoly that in my opinion is the cause of high taxes by the failure to provide an adequate supply of money.

In support of this statement besides the comparison of the record of the Bank of Canada and the Boston Federal Reserve Bank, there is an opinion by Robert L. Owen who guided the finances of this country during World War I without any material debt and with low taxes and no interference with the internal affairs of the States and no meddling by Federal collection of payroll taxes for extortion of money from taxpayers before the end of the taxable year.

There is also enclosed exhibit B that indicates a way to provide an adequate supply of money as provided under the guidance of Robert Owen and reduce the Federal debt to one-half the amount now outstanding.

This would also make free for possession by the United States Treasury all the gold certificates that are now in the hands of private bankers who control the Federal Reserve System. This also would provide the means to use those gold certificates by our European allies or others to provide a system of money and currency and relieve this country from any dictatorship or internal management of affairs of our European allies.

The present guardianship by the United States of the internal affairs of our European allies seems to indicate they are so helpless and incompetent that they can't run their own affairs.

This also will relieve the United States from any occupation of any country by the United States troops.

If advisable, money and credit provided under this system would produce local armies made up of citizens of each country and relieve the United States of the stigma that the United States is trying to be the dictator of a great part of Europe and of the world.

There is also enclosed exhibit C which is a copy of the last annual report of the Bank of Canada, showing how simple and wise Canada is in this branch of its public affairs. It would seem to me that if Canada has set this example for the United States that this country should do as well or better in this branch of our Government.

Yours truly,

MASSACHUSETTS SOCIAL SECURITY ASSOCIATION, INC.,
RICHARD H. LONG, *Director.*

(Exhibits A and B referred to in the above letter follow. Exhibit C has been made a part of the official record and is on file with the committee.)

EXHIBIT A

Comparative statement of condition of Boston Federal Reserve Bank and Bank of Canada

BOSTON FEDERAL RESERVE BANK

Assets:	
Gold certificates	$865,182,941.50
U. S. Government securities, system account	1,302,811,000.00
Other assets	324,755,289.27
Total assets	2,492,749,230.77
Liabilities:	
Federal Reserve notes in actual circulation	1,397,144,130.00
Total deposits	837,066,164.88
Capital paid in	12,001,000.00
Surplus and reserve	41,355,271.28
Other liabilities	205,151,764.61
Total capital accounts and total liabilities	2,492,749,230.77
Current earnings:	
Earnings	181,615.46
U. S. securities system account	21,419,245.23
All others	10,348.11
Total current earnings	21,611,208.80
Current expenses	5,472,544.82
Transferred to reserve for contingencies	2,733,000.95
Paid to U. S. Treasury, interest on outstanding Federal Reserve notes	12,877,827.41
Surplus Dec. 31	80,778,153.80
Cost to United States:	
Interest	21,419,248.00
Expense	5,472,544.00
Private profit	2,733,000.00
Loss of use of gold certificates 5 percent	43,260,000.00
	72,885,701.00
Credit for payment to U. S. Treasury	12,877,827.00
Loss for 1949	60,007,874.00
Accrued loss put in surplus	41,355,271.00
Total loss	101,363,145.00

BANK OF CANADA

Assets:	
Foreign exchange	112,088,980.34
Investments	2,189,686,683.17
All other assets	48,555,091.49
Total assets	2,350,330,755.00

Comparative statement of condition of Boston Federal Reserve Bank and Bank of Canada—Continued

BANK OF CANADA—Continued

Liabilities:	
Capital and rest fund	$15,050,366.82
Notes in circulation	1,367,421,840.52
Deposits	830,019,475.29
Liabilities payable in foreign currencies	133,560,518.85
Dividend declared	112,500.00
All other liabilities	4,160,053.52
Total liabilities	2,350,330,755.00
Profit for year ending Dec. 31, 1950	10,887,548.41
Appropriated as dividends	225,000.00
Balance transferred as credit to receiver general	10,662,548.41
As the Bank of Canda shows a profit for 1950 of	10,887,548.41
And the Boston Federal Reserve Bank a loss for 1949	101,363,145.00
The Bank of Canada appears to have wiser business methods by	121,250,693.41

At that rate if the United States can follow Canada's leadership in banking, there will be a saving of more than 3 billions a year.

Twenty-five years ago today, Woodrow Wilson, in the presence of members of his Cabinet, chief executive officers, the leaders of the United States Senate and House of Representatives, approved the Federal Reserve Act. Three solid gold penholders and pens had been prepared for the occasion. Three original copies of this act were printed in parchment and signed by Hon. Champ Clark, Speaker of the House of Representatives; Hon. Thomas R. Marshall, President of the Senate; and the President of the United States.

One of these copies went to the Secretary of State, Hon. William Jennings Bryan, for permanent record. One of the copies was presented to Hon. Carter Glass, chairman of the Committee on Banking and Currency of the House of Representatives, and one was presented to the chairman of the Committee on Banking and Currency of the United States Senate. One of the gold pens was given to Hon. William Gibbs McAdoo, Secretary of the Treasury; one to Hon. Carter Glass; and one to the chairman of the Senate committee.

This act was generally regarded as the greatest achievement of that administration.

Under this act $40,000,000,000 of liquid money was created to finance the World War. It financed not only the United States, but financed to the extent of billions of dollars, Great Britain, France, Italy, and their allies. "That one act won the war," said John Skelton Williams, Comptroller of the Currency.

The United States came out of this war in a highly prosperous condition. This prosperity was the result of the expansion of credit and currency which enormously stimulated production and employment.

In 1921 those in control of the Federal Reserve System contracted credit and currency by the use of the great powers of the Federal Reserve Act. It resulted in depression.

Again in 1929–32 another depression followed the contraction of the money supply. And a third depression took place in 1937 from a similar cause.

The Federal Reserve System is supported by men of all parties. Under no circumstances should it be considered in a partisan light. The operation vitally affects the economic and financial condition of the entire country, including the Government itself.

There is lacking in the United States an informed public opinion as to the cause and cure of depression.

With the hope of laying the foundation for a better understanding of the principles of the Federal Reserve System and the use of its powers to restore prosperity and prevent future depression, this commentary is submitted for the considerate judgment of leaders of public opinion in the United States.

EXHIBIT 13

Plan to—

Refund the public debt.
Restore real value of United States bonds.
Protect solvency of insurance companies and banks.

Provide adequate funds for financing private and public business in the United States.

Increase interest by savings banks.

Offer option to all bond and security holders, including gold certificates, 50 percent in new bonds with 5 percent interest payable in 10 years, 50 percent in new United States money.

Establish a United States bank to take over Federal Reserve System.

Provide United States money enough to permit banks to carry 25 percent of demand deposits in legal-tender money and report financial condition showing legal-tender money on hand.

Provide United States money enough for business having consideration of prices of food and other living costs.

This will provide the following conditions:

Under this plan suggeted by the writings and policies of Robert L. Owen, author of the Federal Reserve Acts, the following results will be available:

United States public debt	$125,000,000,000
Lawful money in circulation	75,000,000,000
Lawful money in banks	25,000,000,000
Lawful money in U. S. Treasury	25,000,000,000
Taxable property increase	50,000,000,000
United States gold free of debt	22,000,000,000

This condition will permit business in the United States to extend trade and commerce with Canada and other countries and increase wealth and employment in the United States.

This condition will permit loaning friendly allies 5 billions of gold to establish an adequate money and currency supply and save the United States from issuing bonds to loan money to allies.

By this plan the following can be provided with the following benefits and protection:

Income-taxes maximum, 25 percent.

Individual income tax minimum exemption, $2,000.

Abolition of all advance estimate of income for tax purposes and no more payroll deductions.

The United States will collect and levy taxes only after end of taxable year.

Benefits

Estimated increased individual income by 50 billions.

This plan will permit loan of 5 to 10 billions of United States gold to European allies for a basis for currency and make them free financially and no more burden to our taxpayers.

Protection

This plan will save commercial banks from impending bankruptcy as they are now running with only 2 percent of demand deposits in legal-tender money and making false reports of cash on hand.

Statement of National Lawyers' Guild, New York, N. Y.

ESSENTIALS OF AN EQUITABLE TAX PROGRAM

In fashioning the new tax program, there is an insistent and primary need to hold fast to the basic principle that taxes should be fair and nondiscriminatory and imposed in accordance with ability to pay. This means that special privileges in our tax laws should be eliminated. It means that taxes which cannot be adjusted to differences in income or family responsibility, such as sales taxes, should be avoided. It means that undue profits should be recaptured wherever they occur. Unreasonable profits are not necessary in order to achieve maximum production with economical business management. Our people will not tolerate the retention of undue profits at a time when men called into military service are asked to make the utmost sacrifice. And, finally, tax burdens should not be imposed which undermine the health, strength, and morale of the American people.

TREASURY'S TAX PROPOSALS

The Treasury's program for $10 billion in new revenues contemplates raising an additional $3 billion from the corporation income tax, $4 billion from the individual income tax, and about $3 billion from selective increases in excise tax rates. The Treasury also recommended that loopholes be closed.

The principal changes recommended by the Treasury for raising the additional $10 billion are as follows:

1. *Corporations.*—The normal tax rate would be increased by 8 percentage points. Thus, the normal tax rate would rise from 25 to 33 percent. On net income over $25,000, the combined rate would increase from 47 to 55 percent. Income subject to excess-profits tax would be taxed at 85 percent (now 77 percent). The combined 62-percent ceiling rate for excess-profits and income tax would be raised to 70 percent.

2. *Individuals.*—The rate in each income-tax bracket would be raised by 4 percentage points. The effective 25-percent rate on long-term capital gains would be raised to 37½ percent for both individuals and corporations. Instead of the 6-month holding period for a long-term capital gain, the holding period would be increased to 1 year.

3. *Excise taxes.*—An increase of one-third to one-half in the tax rates on alcoholic beverages, cigarettes, and cigars to raise over $1.2 billion. The yield of the gasoline tax to be increased $580 million by raising the present tax of 1½ cents per gallon to 3 cents. About $1.1 billion to be raised by increasing the tax on passenger automobiles from 7 to 20 percent of the manufacturer's price and increasing the rate of other manufacturers' excises on durable goods (refrigerators, radios, electric appliances, phonographs, etc.) from 10 to 25 percent.

REVENUE ESTIMATES AND MAIN PROVISIONS OF HOUSE BILL (H. R. 4473)

H. R. 4473 (the proposed Revenue Act of 1951), which passed the House on June 22, is estimated to raise an additional $7.2 billion in a full year of operation.[1] As noted in the Ways and Means Committee Report, "this is the largest amount of additional money collected from a tax bill in the history of this country." Together with $6.1 billion obtained under the Revenue Act of 1950 and the $3.9 billion under the Excess Profits Tax Act of 1950, the annual increase in Federal revenues since 1950 totals $17.2 billion. It is anticipated that with the enactment of H. R. 4473, tax collections in the fiscal year 1952 will total $66.3 billion.

The major changes provided in H. R. 4473 are: (1) Individual income taxes are raised by 12½ percent effective September 1, 1951 (yield, $2,854 million increment); (2) heads of households are given half the benefits of income splitting for future years (loss: $56 million); (3) the income-tax rate on corporations is raised by 5 percentage points, increasing the combined normal tax and surtax on profits above $25,000 from 47 to 52 percent, yielding $2,085 million additional; (4) the excess-profits credit is lowered to include only 75 percent rather than 85 percent of 1946–49 earnings (yield: $732 million increment); (5) major changes in the excise taxes provide increases on alcoholic beverages, tobacco, gasoline, and automobiles and impose a new tax on wagering; (6) withholding on dividends and certain interest and royalty payments.

While the House bill increases the tax burden on those with little incomes by reason of the 12½-percent increase in individual income taxes and the increases in excise taxes, it fails completely to close any of the glaring loopholes now found in the income-tax structure. Ironically, the Ways and Means Committee did in fact expand the avenues of tax escape. The income-splitting feature is extended to family heads; family partnerships, invalidated under court decisions, are validated permitting income-splitting among members of the family; percentage depletion, instead of being restricted, is extended to a long list of nonmetallic minerals, and increases the percentage allowance for coal from 5 to 10 percent; coal royalties will be taxed at low capital-gains rates. The Treasury estimates that $550 million will be lost annually (full year's operations) because of the revenue-losing provisions incorporated in the House bill. Thus, those with real ability to pay are allowed to escape their share of taxes which loss must be borne by the public by additional tax burdens. Special privileges are extended at the very time that increased revenues are demanded from those with insufficient incomes to maintain minimum standards of health.

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[1] The increase in tax liabilities by $7,200 million is broken down as follows: Individual income tax, $2,847 million; corporate income and excess-profits tax, $2,855 million; excise taxes, $1,252 million; structural changes, $245 million; total, $7,199 million.

THE PAY-AS-YOU-GO CONCEPT

The Treasury continues to advocate raising $10 billion in additional revenues toward the end of balancing the budget. The fetish of an annually balanced budget may, however, be detrimental to the national interests. However desirable the goal of a balanced budget, the period over which it should be achieved cannot be arbitrarily fixed within the 12-month span constituting a fiscal year. Budget policy and tax policy should aim to promote the economic and social welfare of the people and the national interests. The dangers of an inflexible policy of seeking an annually balanced budget have been set forth by Randolph E. Paul, formerly Tax Adviser to the Secretary of the Treasury during World War II:

"One thing that we must get out of our heads is the obsolete concept of the annually balanced budget, which has been derived in part from a false analogy to the individual's budget. The dogma of a balanced budget often fails to fit the economic situation. Although at times a balanced budget may be desirable, at other times it would be disastrous."[2]

The tax load to be assessed against individuals and business enterprises cannot be controlled by the single consideration of an annually balanced budget. Nor can oppressive taxation be justified by declaiming against any increase in the public debt. Care must be exercised that taxation and other policies advocated in the name of keeping down the public debt do not exert such a depressing effect upon the national economy as to result in an actually heavier debt burden. Here it is well to recall Mr. Paul's observations on the national debt:

"It is at least clear that the national debt is no occasion for black defeatism. What we need is a new outlook. We need to exercise the old-fashioned taboo against the national debt. The debt does not betoken economic ruin; it can be maintained indefinitely. This country has not been wholly out of debt since 1837. We need to recognize clearly that public debt is unlike private debt."

The important principle to keep in mind is that taxes should be levied from sources able to pay and that no arithmetic figure can arbitrarily be chosen to measure the tax burden. Oppressive tax burdens which undermine the health and morale of the people cannot be justified by appeals for a balanced budget or a managed public debt.

THE INEQUITY OF OVERTAXING THE LOW-INCOME GROUPS

In his appearances before the congressional committees, Secretary Snyder stressed the point that the low-income groups must be taxed if the revenue goals are to be reached. Thus, before the Ways and Means Committee on February 5, 1951, Secretary Synder stated: "It is estimated that 83 percent of all taxpayers and 58 percent of their taxable income is accounted for by the income groups below $5,000. This concentration of income must be kept if the tax is to raise enough revenue."

This thesis presupposes that revenues cannot be raised from other sources—a thesis not supported by the facts—and wholly overlooks the critical question as to whether the low-income groups can or should properly bear and tax burdens beyond existing levels.

Here it should be noted that families earning under $5,000 annually are already heavily taxed. Thus, according to estimates of the United States Treasury, over $8 billion will be collected from these families in income taxes alone during 1951, on the basis of existing tax levels. Billions more will be paid by low-income families by reason of the excise taxes levied on cigarettes, beer, gasoline, cosmetics, and other consumer goods.

One must not overlook that the tax rates now imposed on the low-income families are already near the peak rate of World War II. Because of rising prices, the $600 exemption allowed for each dependent actually buys much less food, clothing, and shelter than the $500 exemption (then submarginal) allowed during World War II. Democracy in taxation would require an upward revision of the $600 exemption per capita to enable American families to maintain at least minimum standards of health and decency.

The simple fact is that millions of families are already paying Federal income taxes although their savings cannot support the minimum requirements of decent family living. The United States Department of Labor recently released findings which showed that a city family of four required a minimum of from

[2] Paul, Randolph E., Taxation for Prosperity, p. 228.

$3,453—in New Orleans—to $3,038 in Milwaukee—to maintain minimum standards of health and decency. Families with earnings below these minimum levels will be required to pay more than $3 billion in Federal income taxes alone in 1951. Taxes exacted from such families are, in fact, taken from people whose living standards are already below the acceptable minimum. It is indeed callous thinking to advocate additional burdens on the already heavily burdened low-income families merely because there are so many of them and because statistically they may constitute a large majority of all taxpayers. These low-income families need every penny of their earnings to make both ends meet and are already overtaxed very heavily.

In order to place the individual income tax structure on an equitable and democratic foundation, which requires exemptions adequate to maintain minimum standards of health and decency, the lawyers recommends that a single person have an exemption of $1,200 (instead of the existing $600) and that married couples have an exemption of $1,800 (instead of the existing $1,200). Thereunder a family of four would pay no income tax if its gross income were less than $3,330. Elemental decency requires that those with real ability to pay should be called upon to bear their fair share of additional revenues. There can be no justification for special privilige.

The contrast in income and expenditures between the upper-income and lower-income families is strikingly revealed in the findings of the Consumer Income Studies of the Federal Reserve Board of the National Income Statistics of the United States Department of Commerce. In 1948, the top tenth of American families by income (those earning $6,000 and over) received 20 percent of the money income after payment of taxes, a total of about $51 billion. After setting aside about $9 billion in savings—these families accounted for practically all of the savings—they had about $42 billion left they used for personal consumption.

Up to 50 percent of American families at the bottom of the income ladder earned only 25 percent of the income—about $44.5 billion. These low-income families—all of whom earned less than $2,840 in 1948—had no net savings; they actually went $2 billion in debt in order to spend about $46.5 billion in consumption—hardly more than was spent by the highest income 10 percent of the families at the crest. Surely, the incomes in the top brackets should be taxed more heavily before considering reducing the living standards of low-income families still further.

The 1949 survey of consumer finances provides some interesting information about the families purchasing durable goods—automobiles, furniture, television sets, radios, and household appliances. In 1949, 41 percent of the total expenditure for these items was made by the 20 percent of the families at the top of the income ladder, while the lowest-income 60 percent of the families at the bottom accounted for only 36 percent. It is not the low-income groups in this country whose buying power is exerting inflationary pressure on durable goods—it is the family at the top of the income ladder.

It is, therefore, sound anti-inflationary policy to siphon off as much as possible of the incomes of the higher-income brackets, through income and corporation taxes, and to resist all attempts to increase the tax burdens on low-income groups, through sales taxes, higher tax rates or otherwise. Thereby the incomes which threaten inflation will be diverted without impairing the health and stamina of those families which have insufficient earnings to maintain the minimum requirements of health and decency.

LAWYERS' GUILD TAX PROGRAM

The National Lawyers Guild advocates a four-point program for the Revenue Act of 1951:

I. Eliminate special privileges and close existing loopholes in our tax laws to yield an additional $4 billion.

II. Overhaul the gift-estate tax structure to produce an additional $1 billion.

III. Increase taxes on corporations mainly through revision of the excess-profits tax to yield at least $5 billion.

IV. Increase personal exemptions for a married couple to $1,800, and $1,200 for a single person.

Under this program there will be no necessity to increase the rates of any brackets in the individual income tax. And there will be no necessity to increase excise taxes. The program here advocated would tap ability-to-pay sources and remove inequities in our Federal tax system. In the succeeding sections we detail the concrete proposals necessary to effectuate the first three points of our program.

Point I. Elimination of special privileges

1. *Income splitting.*—The split-income provisions introduced in the Revenue Act of 1948 granted generous bounties to upper-bracket couples, the bounty increasing with a rise in income. It is no answer to say that universal income splitting was adopted in order to "correct" tax discrimination between residents of community and noncommunity property States. If one State were plague-ridden while the other healthy, no one would suggest introducing bacteria into the healthy State to achieve equality between the two States. But this is precisely what was done in the income-splitting provision. The unwarranted favoritism enjoyed by residents in community States, instead of being eliminated, was projected into all non-community-property States. Instead of mandatory joint returns, advocated by the Treasury during the Roosevelt regime, universal income splitting was enacted. Secretary Snyder, in his testimony before the Ways and Means Committee in February, made no concrete-recommendation to eliminate this inequitable provision. He stated: "The committee will undoubtedly want to examine this problem in all its implications before completing this year's tax legislative program." In contrast to this noncommittal attitude, the Secretary, in referring to the income groups below $5,000, stated: "This concentration of income must be kept if the tax is to raise enough revenue." The continuance of the income-splitting provision undermines the income-tax structure as a progressive instrumentality. It should be eliminated at this session in the present revision of the tax system. But instead of eliminating the inequitable income-splitting program, the House has extended this feature (to the extent of 50 percent) to heads of households.

2. *Percentage depletion.*—Percentage depletion is a glaring inequity which should forthwith be eliminated. Taxpayers should hereafter be permitted to obtain depletion only on a cost basis. Under existing law, owners of oil wells and mines are allowed to deduct 27½ percent of gross income in the cases of oil and may amount to 50 percent of the net income. But unlike other capital recovery allowances, percentage depletion continues to be deductible even after the entire investment has been recovered tax-free. Thus, the total deductions may ultimately equal many times the taxpayer's actual investment.

On top of these overgenerous depletion allowances, oil producers are permitted to make immediate deductions of their expenditures for drilling and development. Capital investments thus written off do not in any way reduce future percentage depletion deductions. Thus, the oil producer receives a double deduction with respect to the same capital investment. In this manner, tax liabilities running into hundreds of millions of dollars each year are wiped out—which depletion in revenues must, of course, be offset by higher taxes on those less favored.

The Treasury proposed that the rate of percentage depletion be reduced to 15 percent of gross income for oil, gas and sulfur, and to 5 percent for nonmetallic minerals. The Guild proposes that depletion be permitted only on a cost basis—a recommendation made by the Treasury in considering the 1942 revenue bill. In addition, the existing option to capitalize or expense intangible drilling and development costs should be eliminated for both oil and gas wells and mines, and hereafter such costs should be charged to capital account.

If it is desired to offer a tax advantage as an inducement to new discoveries, we suggest that percentage depletion at a rate of 15 percent be allowed to a taxpayer who in the future discovers a new pool of oil or gas—each new zone or horizon being considered a new pool. This allowance of percentage depletion should be limited to those taxpayers who contribute substantially toward the cost of the exploratory well. As to metal mines, and nonmetal mines or deposits including coal mines developed in the future, the allowance should be 10 percent and 5 percent, respectively.

In this important area, the House, instead of curtailing depletion allowances, has in fact provided for additional percentage depletion allowances.

3. *Tax-exempt securities.*—For years the Lawyers Guild has been a leading advocate of the termination of immunity from tax of interest on all intergovernmental securities, both outstanding and future issues. The law now provides for the taxation of all interest on Federal securities issued since March 1, 1941. Because of tax-exemption clauses which appeared in many of the outstanding issues of Federal securities issued prior to that date, the interest thereon cannot be reached. No action has been taken, however, with respect to the interest on future or outstanding State and local securities. Through tax-exempt securities, persons with large taxpaying ability find themselves in a sheltered

position. The holders of such tax-exempt securities are obtaining what are essentially windfall profits at a time when heavy burdens are imposed upon large sections of the population.

If this burden were not so heavy, there would be much to be said for the gradual elimination of this tax immunity by starting with a tax on interest on future issues only. But this gradual approach is unacceptable in the face of the heavy demands made by the National Government. We, therefore, recommend repeal of the present exemption applicable to outstanding issues of State and local securities.

In the case of State and local securities, there has never been any contract or moral commitment between the Federal Government and the security holders or the State and local governmental authorities regarding Federal taxation. Since the Supreme Court decision in the case of Graves against O'Keefe in 1939, the power and moral right of the Federal Government to tax the income from State and municipal securities is unchallenged.

A tax system cannot be defended which calls upon the great mass of our taxpayers to shoulder unprecedented tax burdens and yet permits persons with large tax-paying ability to escape their share of the tax load by investing in tax-exempt securities.

4. *Capital gains.*—The treatment of capital gains is another glaring example of a special privilege in our tax law. The maximum effective date on long-term capital gains (where the assets has been held for more than 6 months) is only 25 percent; and may be included to the extent of 50 percent in taxable income and subjected to regular rates if this results in a lesser tax.

The "capital gain" provision first introduced into our revenue legislation by the 1921 act and retained with changes in later acts was originally designed primarily to save from prohibitive surtaxes profits of individuals derived from the sale or exchange of capital assets representing an increment in value over a period of 2 years or more. This principle was implemented by including a percentage of the capital gain in income. Thus, under the 1934 act, 100 percent of the gain was taxable if the capital asset has been held for less than a year, 80 percent if held for more than 1 year and less than 2 years, 60 percent if held for more than 2 but less than 5 years, 40 percent if held for more than 5 but less than 10 years, and 30 percent if the capital asset had been held for more than 10 years. By taxing only a percentage of the total capital gain, the effect of lumping the total capital gain in a single year was counteracted. During the early revenue acts, however, there was no ceiling on the effective rate. The relief was afforded by reason of the fact that only a percentage of the total capital gain was subjected to the regular rates.

The current Treasury proposal is that the alternative capital-gains rate be increased from 25½ to 37½ percent—an increase of 12½ percent—and also that the unduly short holding period of 6 months be lengthened to 1 year. The House increased the liability under the present 25 percent rate by 12½ percent, raising the alternative rate to 28.1 percent, retaining the short holding period of 6 months. This puny increase fails utterly to meet the problem.

Viewed in this historical background, it becomes apparent how overgenerous are the present provisions. Thereunder, a capital asset held for 9 months—less than 1 year—is subject to a maximum effective tax of 25 percent. But clearly, under such circumstances, the gain having been realized within the period of 1 year, there is no occasion for affording relief, since the increment in value was realized within the period of one taxable year. And, ironically, the maximum effective rate on capital gains, namely, 25 percent, is only slightly higher than the initial rate in the lowest tax bracket. But, surely, relief from the higher tax levy over a period of years into a single tax year does not justify a tax levy at the rate applicable to the bottom rungs in the present tax ladder. If a taxpayer, for example, were in the 75-percent bracket during the period when he held securities or other capital assets, the profits from the sale of such securities would be subjected to a minimum of 75 percent, whether the increment in value were taxed each year (although unrealized), but there can be no earthly reason for reducing his tax levy below the level he would have been subject to if the increase in value were taxable annually.

To eliminate the existing favoritism, we should return to the principles originally embodied in the revenue acts. In the interest of equity for all taxpayers in all brackets, capital gains on assets held for less than 1 year should be taxed at 100 percent. For assets held more than 1 year, the principle of including a percentage of the total capital gain should be adopted—with no ceiling as to rates. The rates embodied in the 1934 act present a rational approach to the problem.

If for reasons of simplicity, it is desired to consolidate the categories for holding periods beyond 1 year, we recommend that 75 percent of the gains on assets held for more than 1 year and less than 2 years be taxed as ordinary income, and that 50 percent of gains be included in ordinary income for assets held for more than 2 years. These recommendations will not only restore rationality and equity in the tax treatment of capital gains but will also tend to curb speculation and at the same time provide a more effective taxation of speculative profits.

Point II. Estate and gift taxes

Estate and gift taxes should be overhauled and strengthened in the interests of distributing the tax burden fairly. The structure of the estate and gift taxes permits large amounts of transfers to be made with no tax or at a very low tax rate. The defective structure stems principally from: (1) The double exemptions available under the gift tax ($30,000) and the estate tax ($60,000); (2) the opportunity to escape the higher estate tax rates by making gifts subject to lower tax rates; (3) the low levels of the present rate schedules; and (4) the excessively favorable treatment of property placed in trust for several generations. These defects were accentuated by the estate and gift-splitting provisions introduced by the Revenue Act of 1948.

We recommend that the gift and estate taxes be integrated into a single coordinated system with a single exemption and a single set of rates, progressively graduated. The estate and gift-splitting revisions should forthwith be repealed. The preferential tax treatment now enjoyed by property placed in trusts should be terminated so that this category of transfer should bear its appropriate tax burden. New revenues of $1 billion could be raised by overhauling the estate gift tax structure along the lines here proposed.

Point III. Corporate taxes

Corporate profits have risen spectacularly during 1950 to reach the highest levels on record, as sales and prices climbed to new highs. The volume of dividends swelled to new all-time highs and undistributed profits were the second highest on record. According to statistics submitted by Secretary Snyder at the hearings before the House Ways and Means Committee, corporate profits at the end of 1950 were running at the annual rate of $48 billion. At this rate, Federal, State, and local corporate taxes, including the excess profits tax, would absorb $23.5 billion, leaving $24.5 billion after taxes. Thus, corporate profits after taxes would approach the peak level of profits before taxes during World War II. In 1943—the peak year—corporate profits before taxes reached $25.1 billion; and, after taxes of $14.4 billion, corporate profits after taxes amounted to $10.6 billion.

We recommend that an additional $5 billion be raised in corporate taxes, mainly through revision of the excess profits tax. Even after the impost of this $5 billion additional tax, corporations would retain profits, after taxes, above the level existing during 1946–49, a period of unusual and sustained prosperity. Corporations would thus have available adequate funds for dividends and expansion.

The bulk of the increased corporation tax should fall on excess profits. Taxes paid from excess profits have less disrupting effects on business than taxes which are generally applicable to all corporate earnings irrespective of the rate of return. A tax which absorbs excess profits still leaves the corporate taxpayer with a sufficient margin of income for dividends and safety. On the other hand, a tax which dips too deeply into the incomes of low-earning corporations may seriously affect their debt-paying capacity, if not their very existence. It is significant that big business stoutly resists excess profits taxation, preferring higher "normal taxes" which fall on all corporations.

The newly enacted excess profits tax is unnecessarily generous and is not designed to tax effectively the sources from which emanate those profits which must be looked upon as excess in the harsh light of current events.

The theory of the new excess-profits tax is that a "normal" standard of earnings is the higher of (*a*) 85 percent of the average of the incomes of the best 3 out of 4 years in the 1946–49 period or (*b*) 12 percent on the first $5 million of invested capital, 10 percent on the next $5 million and 8 percent on amounts over $10 million. Profits above that are deemed "excess" profits taxable at 30 percent, but a ceiling rate of 62 percent is provided which can have the effect of cutting down the corporations' excess-profits tax liability. In addition, numerous relief provisions limit the amount of profits subject to this tax.

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