

# REVENUE ACT OF 1962

---

---

HEARINGS  
BEFORE THE  
COMMITTEE ON FINANCE  
UNITED STATES SENATE  
EIGHTY-SEVENTH CONGRESS  
SECOND SESSION  
ON  
**H.R. 10650**

AN ACT TO AMEND THE REVENUE ACT OF 1954 TO PROVIDE A  
CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROP-  
ERTY, TO ELIMINATE CERTAIN DEFECTS AND INEQUITIES,  
AND FOR OTHER PURPOSES

---

MAY 10 AND 11, 1962

---

**PART 10**

---

Printed for the use of the Committee on Finance



U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1962

82100

## COMMITTEE ON FINANCE

HARRY FLOOD BYRD, Virginia, *Chairman*

ROBERT S. KERR, Oklahoma

RUSSELL B. LONG, Louisiana

GEORGE A. SMATHERS, Florida

CLINTON P. ANDERSON, New Mexico

PAUL H. DOUGLAS, Illinois

ALBERT GORE, Tennessee

BERNAN K. TALMADGE, Georgia

KUENE J. McCARTHY, Minnesota

VANCE HARTKE, Indiana

J. W. FULBRIGHT, Arkansas

JOHN J. WILLIAMS, Delaware

FRANK CARLSON, Kansas

WALLACE F. BRENNETT, Utah

JOHN MARSHALL BUPLER, Maryland

CARL T. CURTIS, Nebraska

THRUSTON B. MORTON, Kentucky

ELIZABETH B. SPRINGER, *Chief Clerk*

# CONTENTS

Departmental reports:	Page
Bureau of the Budget on H. 2000.....	4100
Interior on H.R. 10050.....	4245
Labor on H.R. 10050.....	4246
State on H.R. 10050.....	4248
Treasury on--	
H. 2.....	4309
H. 378.....	4309
H. 580.....	4309
H. 715.....	4309
H. 720 (context of which was introduced as amendment 4-B-62-15 to H.R. 10050).....	4309
H. 2000.....	4309
H. 2710.....	4308
<b>WITNESSES</b>	
Dillon, Hon. Douglas, Secretary of the Treasury.....	4250
Changes in H.R. 10050 recommended by the Treasury Department.....	4287
Comparison of increases requested and achieved in number of Internal Revenue Service employees, fiscal years, 1960-63.....	4283
Computation on withholding.....	4331
Data on assignment of taxpayer account numbers (based on 1959 statistics of income data).....	4279
Estimated dividend income of individuals not accounted for on tax returns for 1959.....	4355
Estimated dividend income of individuals not accounted for on tax returns for 1960.....	4354
Estimated interest gap 1959 to 1960.....	4357
Estimated interest income of individuals not accounted for on tax returns for 1960.....	4356
Excerpt from remarks of Hon. Douglas Dillon, Secretary of the Treas- ury, before the Business Council, Hot Springs, Va., May 11, 1962, as delivered by Under Secretary of the Treasury Henry H. Fowler.....	4382
Hypothetical case on withholding.....	4329
Letter of Stanley S. Surrey, Assistant Secretary of the Treasury, to Hon. John J. Williams, May 17, 1962, re Virgin Islands.....	4391
New York Times clipping re Japan Fund, Inc.....	4343
Operation of withholding on coupon interest received by nonresi- dent aliens, etc., under existing law.....	4394
Revenue effect of withholding on dividends and interest under H.R. 10050 (based on revised 1959 data).....	4354
Revenue effect of withholding on dividends and interest under H.R. 10050 (based on 1960 data).....	4354
\$75,000 exemption level established in 1912.....	4334
Summary of gap and revenue data, 1959, 1960, and projected for 1963.....	4353
Total tax collections as a percent of GNP and national income, 1959 (Includes State and local taxes).....	4259
Total tax collections as a percent of GNP and national income, the United States and nine foreign countries.....	4258
Treasury memorandum in reply to public statements by George E. Barnes, of Chicago, Ill., with regard to dividend nonreporting.....	4304
Use of information returns—form 1099.....	4276

## COMMUNICATION

	<b>Page</b>
<b>Palewosky, Hon. Ralph M., Governor of the Virgin Islands, statement....</b>	<b>4205</b>

## STATEMENT OF THE CHAIRMAN

<b>Statement of Senator Harry F. Byrd (Democrat, Virginia) on Section 2, Investment Credit, and Section 10, Withholding Tax on Dividends and Interest, of H.R. 10050.....</b>	<b>4400</b>
---	-------------



# REVENUE ACT OF 1962

THURSDAY, MAY 10, 1962

U.S. SENATE,  
COMMITTEE ON FINANCE,  
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Long, Smathers, Anderson, Douglas, Gore, Talmadge, McCarthy, Hartke, Williams, Carlson, Bennett, Curtis and Morton.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam, and L. N. Woodworth, economist, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. I submit for the record the statements of the Secretary of the Interior, the Secretary of Labor, and the Secretary of State.

(The statements referred to follow:)

THE SECRETARY OF THE INTERIOR,  
Washington, May 9, 1962.

HON. HARRY FLOOD BYRD,  
Chairman, Senate Finance Committee,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Statements by the President and the Secretary of the Treasury have made abundantly clear the way in which the enactment of a law incorporating the investment tax credit would promote the overall national interest. They have stressed how this provision would better enable us to achieve our national objectives of a sustained recovery, an accelerated rate of economic growth, and the balance of our international payments so necessary to the maintenance of our oversea military forces and the successful conduct of our foreign policy in its confrontation with the Sino-Soviet bloc. As Secretary of the Interior, I would like to add my views as to how this legislation now before your committee could be of great assistance to our Nation's fishing industry.

The investment credit provision is important to the future of the domestic fishing industry. It will help many hard-pressed vessel owners and processing firms remain competitive by investing in new and more modern equipment.

As you know, obsolescence of productive equipment has become a serious problem for many segments of our U.S. fishing industry as for other major industries on which the welfare of this Nation and its defense depend. The investment credit is designed to provide real encouragement and financial assistance to the firm undertaking to modernize or further develop its productive capacity.

In general, the credit will provide a tax reduction equal to 8 percent of the cost of new vessels, machinery, and equipment put in use in 1962 and later years. Thus, a firm with a tax liability of \$50,000, which invests \$100,000 in eligible new equipment in 1962 would have its tax liability reduced by \$8,000 (8 percent of \$100,000) to \$42,000. In combination with an effort which will be made to revise depreciation schedules used by the Treasury for tax purposes, the investment credit should provide a real and tangible incentive for modernization

to cut costs and strengthen the earnings position of firms in the fishing industry. It should go far toward relieving the financial distress of many firms, particularly the smaller ones.

It is not unlikely that many fishing industry firms have not yet become fully aware of the importance of the investment credit to them and their future plans for reequipment. It would be regrettable if they were deprived of the benefits of this major tax incentive reform through oversight or inaction. Rough estimates indicate that the value of the investment credit will be in the order of magnitude of \$5 million for the domestic fishing industry at 1962 levels and more in later years as the industry grows with the rest of our economy.

This legislation is a major part of the President's legislative program this session. It is important not only because of its significance to the fishing industry but also because of the contribution it will make to the Nation's whole economy in this increasingly competitive world.

If I can be of assistance to you in supplying facts or background on this legislation or in any other way, please let me know.

Sincerely yours,

STEWART L. UDALL,  
*Secretary of the Interior.*

STATEMENT BY SECRETARY OF LABOR ARTHUR J. GOLDBERG TO THE SENATE FINANCE COMMITTEE ON THE PRESIDENT'S TAX PROPOSALS, MAY 1962

As Secretary of Labor I have four major interests in presenting my views to this committee in support of the President's tax proposals in the form adopted by the House in H.R. 10650. My views may be summarized briefly.

1. The investment tax credit should contribute significantly to a stepping up of the rate of growth of the American economy and to maintaining employment closer to capacity than has been the case in recent years.

2. The provisions dealing with taxation of American enterprises and income abroad should improve employment opportunities at home by removing tax incentives for investment abroad.

3. The investment credit and foreign income proposals taken together should contribute significantly to the easing of our balance-of-payments position and permit more vigorous expansion of the American economy.

4. The proposals as a whole, including dividend and interest withholdings, should improve and strengthen personal income taxation as the backbone of our tax structure, which I believe to be essential for equitable distribution of the costs of financing Government expenditures.

The present proposals represent the beginning of what I am sure will prove to be the most comprehensive reexamination of the Federal tax system as a whole in many years. The President has indicated he will forward other proposals later this year for improving the tax structure both in terms of equity and effects upon performance of the economy.

The present revisions have particular relevance to immediate problems of stimulating the rate of economic growth, and for dealing with the balance-of-payments problem insofar as possible by means of tax policy, while at the same time eliminating certain tax losses arising from inequities in the treatment of different taxpayers.

TAX INCENTIVES FOR FULL-EMPLOYMENT INVESTMENT

The investment tax credit is a bold step to use the corporate income tax expressly for stimulating the rate of economic growth in the American economy.

The Congress has been concerned for many years with effects of corporate and personal income taxation upon the behavior of the economy. The dividend credit and exclusion provisions of 1954, for example, were intended to encourage investment by affording tax savings to investors; they were, however, not closely enough linked with investment decisions to have significant effect.

The tax investment credit is superior to other proposals, such as general rate reduction, because of its powerful and direct effect upon the expected profitability of new investments while minimizing revenue losses by limiting the tax saving to actual, not potential, decisions to invest.

But do we need to encourage investment? I think we do—to improve our competitive ability in foreign trade by modernizing plant facilities and to achieve a higher level of economic growth.

For most Americans it has come as something of a shock that we can no longer take for granted our technological superiority over other countries. The fact is our relative capacity to compete in foreign markets, and in our own market, is being affected by failure of American industry to increase its productivity as rapidly as it has the capacity, technologically, to do so.

Whatever the cause, the American economy has lagged behind other countries in recent years in capital investment measured as a percentage of gross national product. This is reflected in the lengthening of the average age of our industrial equipment, the inferiority of much of it to the modern and more efficient facilities in the more rapidly expanding industrial countries, and our relatively slow rate of economic growth.

This lag in investment is reflected also in the general deficiency of demand. Unemployment has remained much too large even in the recovery periods of recent cycles. The general deficiency in demand, partly the result of weak investment demand, has curtailed employment opportunities and magnified the difficulties of dealing with problems of structural unemployment.

The investment tax credit is not viewed by this administration as a cure-all for the chronic slack of recent years in the American economy. The President in his Economic Report and other messages has made a series of recommendations to promote growth and to deal with our continuing unsatisfactory employment and unemployment situation. Stimulation of new investment is a crucial need in the present situation, and the investment tax credit is perhaps the most effective single measure we can take, not only in present circumstances, but as a long-range means of achieving a higher capability for growth.

The latest surveys show that investment expenditures can be expected to rise in the period immediately ahead. Observers of the current economic scene, however, are dubious that investments now planned can maintain the upward thrust of the current recovery movement to a full-employment level without additional stimulus.

I may note briefly two objections made to the investment tax credit. One is that we have excess capacity in many lines of industrial activity. Excess capacity, however, is a relative matter; not only is some of it becoming obsolete, but it would vanish quickly at full-employment levels of operation.

A second objection is that we should take measures to increase consumption, and thereby create the need and demand for additional investment, rather than to give special tax privileges to business.

My judgment, on the contrary, is that there is no specific alternative proposal that is likely to be more effective in raising consumer incomes and expenditures at this time. The virtue of the tax credit proposal is that it will contribute to this end without damaging side effects on prices that may accompany measures, whatever they may be, intended to increase consumption directly.

#### IMPROVING THE EQUITY OF THE FEDERAL TAX SYSTEM

As Secretary of Labor I have an equal interest in the other proposals that will contribute to the strength and equity of our tax system by taxing similar income and similar taxpayers in equal fashion.

These specific proposals have the merit in the present situation that they also add additional revenues, and hence offset the loss of revenue expected in the short run, before account is taken of the effects upon the economy, from the investment tax credit.

The proposals relating to taxing of foreign income and investment serve also the purpose in the immediate situation of easing our balance-of-payments difficulties. They do so by eliminating special tax privileges, and thus reducing tax incentives for an outflow of investment funds and the retention of funds abroad, that complicate and worsen our balance-of-payments position. The improvement in our balance-of-payments situation, to which these tax changes will contribute, will have significant effects upon the success of domestic economic policy and in raising employment opportunities.

However, there is no intent to restrict American business activities abroad except insofar as they are motivated and pursued solely for reasons of tax advantage. We have a continuing interest in the economic development of the free world and in the expansion and liberalization of multilateral trade. The aim is to eliminate preferential tax treatment which results in curtailment of job opportunities at home and the burdening of other taxpayers.

Equality of treatment is the guide also for the proposed revisions for withholding on dividends and interest, disallowance of certain entertainment expenses,

and taxation of mutual savings banks, savings and loan associations, mutual fire and casualty insurance companies, cooperatives, and of capital gains on depreciable property.

I wish to limit my comments, however, chiefly to these proposals as they bear upon fairness to the large majority of taxpayers whose income consists almost entirely of wages and salaries. The individual income tax is the principle means by which they pay their share of the costs of the Federal Government. They must necessarily bear a large share of the costs, and there is no fairer way than the income tax.

The individual income tax is no longer a rich man's tax. Prior to World War II the Federal budget was relatively small, and wage and salary workers were left largely untouched. Then only about 4 million taxpayers paid a personal income tax; now 48 million file taxable returns. Approximately 60 percent of these fall wholly within the first-bracket rate. About 85 percent of the revenue yield is at the first-bracket rate, and the average liability on taxable income runs only a few percentage points above the 20-percent first-bracket rate.

We must take every step we can to maintain and increase the reputation of the individual income tax for fairness and to repair the erosion of the tax base that has already reduced its revenue-producing capacity. If we are to continue to use it, as I believe we must, as the major source of Federal revenue.

Because of the high first-bracket rate, relatively low personal exemptions, underreporting of incomes other than wages and salaries, statutory loopholes for various types of nonwage incomes, it is frequently argued that the individual income tax discriminates against low- and middle-income families.

The elimination of special privileges and loopholes, as proposed in the present bill with respect to both corporate and individual income taxation, will result in a fairer distribution of the burden of taxation and a greater sense of equity.

Withholding on wages and salaries was an innovation of the greatest importance in preventing inequities in the reporting of such incomes and, as it has proved, a great convenience and help to wage and salary recipients in paying their fair share of the costs of Government.

Withholding on interest and dividends will guarantee greater equality in effective taxation as between recipients of such incomes and greater equality vis-a-vis recipients of wage and salary incomes. It should contribute to a feeling of greater fairness and to a greater willingness to pay one's own tax obligation. Interest and dividend recipients will in time, I predict, regard withholding as a great boon, in terms of fairness and convenience, as wage and salary recipients now do.

Similarly, the proposal for eliminating abuses which have crept into the reporting of entertainment and other business expenses will help to maintain and increase respect for the fairness of Federal taxation, both by those who enjoy deductions which it is now proposed to disallow and by those who have no access to an expense account. I think this committee will agree there is no reason why a small minority of taxpayers should have what essentially are living expenses or luxuries subsidized by the Federal Government. It contributes not only to a lack of confidence in the fairness of the tax system, it also contributes to the creation of a privileged class that I think is destructive of the quality of American life.

For these reasons, as Secretary of Labor, I strongly endorse the present proposals as a means for strengthening the American economy and increasing employment and, as well, as important first steps for improving the equity of the Federal tax structure.

DEPARTMENT OF STATE,  
Washington, May 14, 1962.

Hon. HARRY F. BYRD,  
Chairman, Committee on Finance,  
U.S. Senate.

DEAR MR. CHAIRMAN: In the course of Secretary Dillon's testimony before your committee on April 2, 1962, with respect to the proposed tax legislation, he requested that the Senate eliminate section 21 from the House bill, H.R. 10650. Section 21 would make inapplicable to the provisions contained in the Revenue Act of 1962 the provision of section 7852(d) of the Internal Revenue Code of 1954 that no provision of the code shall apply where its application would be

contrary to treaty obligations of the United States in effect on the date of enactment of the code. The Department of State would like to go on record as strongly endorsing the views of Secretary Dillon that section 21 should be deleted from the tax bill.

The Treasury Department, which has initial responsibility under tax treaties for resolving questions that may arise between the parties with respect to their interpretation or application, has expressed its opinion, with which we are in complete agreement, that, with one exception, the provisions of the tax bill are not inconsistent with the treaty obligations of the United States. The single exception is the provision on estate taxes which conflicts with a provision in a treaty between the United States and Greece that the passing of real estate situated in Greece shall be exempt from U.S. tax. It is anticipated, however, that the United States will be able to renegotiate the treaty with Greece before the estate tax provision in the Revenue Act becomes fully operative.

The Treasury Department has given its assurance that it has carefully considered the relationship between the tax treaties to which the United States is party and the gross-up provision in the tax bill and has concluded that gross up does not violate U.S. treaty obligations. Apparently, there has been some contrary expression of views by several interested parties, and the Committee on Ways and Means of the House of Representatives inserted section 21 in the bill in order to foreclose the possibility of litigation over this matter.

The Department of State is greatly concerned about the foreign relations problems which it feels would surely arise out of the enactment of section 21 and therefore strongly urges that it be deleted from the bill. While the Department appreciates the desire of the Congress to avoid involving the United States in unnecessary litigation, it believes that it would be undesirable to create serious foreign relations problems on the mere speculation that, without the objectionable provision, the United States might be faced with litigation.

The foreign relations difficulties which the Department believes would ensue from the enactment of section 21 result from the appearance that is created by section 21, when read with section 7852(d) of the code, that the United States is enacting a provision into law which is intended to take precedence over any inconsistent treaty obligations. Of course, it is not the intention of the United States to violate the tax treaties in adopting the gross-up provision, but there is a contrary implication inherent in section 21. It would be difficult for other countries to understand that the sole intent of section 21 was to prevent litigation.

It is important for the United States to support and act in accordance with the principle of the inviolability of treaty obligations in international relationships. We believe it to be extremely important for all countries to accept the view that commitments undertaken in international agreements cannot be ignored or disregarded and that legitimate desire for a change in existing obligations should be brought about through negotiation and agreement between the interested nations. Section 21 would subject the United States to a charge of failing to abide by these principles in its conduct and would make it appear that this country is prepared, when it suits its purposes, to take unilateral action which disregards the rights of other countries under existing treaties without first consulting with them in order to find a mutually agreeable solution which would satisfy the interests of both countries.

For these reasons, the Department of State urges that section 21 be deleted from the Revenue Act of 1902.

Sincerely yours,

GEORGE W. BALL, *Under Secretary.*

The CHAIRMAN. The committee will come to order.

The SECRETARY of the Treasury will please take a seat.

The Chair would like to state that one of the purposes of this meeting is to give the Secretary an opportunity to present his views with respect to some changes in the pending bill, and likewise to give to the Senators an opportunity to cross-examine him, starting with those who were not present when he was on the stand a little while back.

Mr. Secretary, you may proceed, sir.

**STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE U.S.  
TREASURY**

Secretary DILLON. Thank you, Mr. Chairman.

I appreciate this additional opportunity to discuss with you the proposed Revenue Act of 1962. I would also like to suggest some changes in the bill. We have followed closely the suggestions, objections, and recommendations which have been offered in the extensive testimony which has been presented to your committee since April 2.

As the hearings have proceeded, we have held numerous meetings with persons interested in the bill, including some of the witnesses who appeared before the committee as well as representatives of other interested groups. We have worked with them to make technical improvements and to evaluate possible policy changes.

Today, I should like to outline a number of changes which are responsive to matters raised during the hearings and which we believe would improve the bill. These changes seem to us to be clearly called for. Undoubtedly further discussion in executive session will reveal other ways in which the bill can be improved. It is our desire to work closely with you and the staff of the joint committee to produce the most effective, the fairest, and the most practicable bill that can be developed.

**INVESTMENT CREDIT (SEC. 2)**

The language of section 2 of the House bill appears to present no serious technical problems. However, we would recommend that the bill be amended to provide for a 3-year carryback of unused investment credits. Of course, such unused credits should not be carried back to taxable years before those for which the credit is effective. Such a provision would result in greater cash flow benefits during periods of recession when earnings are low or at other times when it may be especially needed by particular businesses.

We would also recommend that livestock be excluded from the credit. The House decided in section 14 that gain on the sale of livestock which reflects prior depreciation should continue to be treated as capital gain rather than ordinary income. We feel strongly that property not subject to the recapture of excessive depreciation should not be granted the investment credit.

A number of witnesses raised questions as to whether specific items were eligible for the credit or would be disqualified as structural components of a building. Some of the items mentioned were refrigerator cases used in the grocery business and testing equipment used in the aerospace industry. The House Ways and Means Committee report indicates that machinery and equipment are to be considered eligible property even though considered a part of the building under local law. This means that such items as refrigerator cases and testing equipment would qualify for the credit even though affixed to a building. Appropriate language in your committee's report could provide further clarification in this area.

**GAINS FROM THE DISPOSITION OF DEPRECIABLE PROPERTY (SEC. 14)**

Some witnesses expressed concern that section 14 may require recognition of gain despite the fact that the taxpayer's method of account-

ing today does not require such recognition. The example given was the normal retirement of property depreciated in a multiple-asset account. Section 1231 today does not require the recognition of gain or loss at the time of such retirement as long as the taxpayer's method of accounting, in accordance with Treasury regulations, clearly reflects income. If the taxpayer's method of composite accounting complies with the Treasury regulations, those regulations should similarly permit and will similarly permit nonrecognition of gain or loss under section 14. A statement in your committee's report, illustrating this point, should allay any concern in this regard.

#### EXPENSE ACCOUNTS (SEC. 4)

In order to ease the accounting problems of concerns supplying articles for use in novelty advertising, we recommend a special exclusion from the \$25 business gift limit in the House bill. Such exclusion would permit the deduction of items costing a modest amount, such as up to \$2 or \$3, regardless of the total gifts to any one customer over the year. It would apply to each gift item on which the name of the advertiser is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the advertiser. Such an exclusion would permit novelty advertising to be carried on free of accounting difficulties in keeping track of a large number of small items without disturbing the curtailment of abuses which the bill provides.

In addition, it was never our intention that advertising devices such as display racks and advertising signs, which are provided for use in business and which are not items of personal use, should be included under the gift provision. We would recommend that the committee report contain language clearly indicating that such items are not business gifts under section 4 of the bill.

#### WITHHOLDING ON INTEREST AND DIVIDENDS (SEC. 19)

We have continued our efforts to work out a withholding system that would be as efficient as possible and at the same time would minimize any possible hardship to the recipients of dividends and interest. We would like now to recommend certain improvements in the provisions for exemption certificates.

The exemption certificate system contained in the House bill applies to savings account interest, certain interest paid by insurance companies, dividends, and patronage dividends, so that there will be no withholding on such amounts received by individuals who owe no tax.

We would recommend that the exemption certificate procedure be extended to dividend income of other nontaxable recipients.

For example, this would include foreign, State, and local governments, and tax-exempt organizations, such as colleges and universities, churches, and pension trusts.

Regarding withholding in the insurance industry, the exemption certificate system should continue to apply to interest on proceeds of life insurance left on deposit with the insurance company but should not apply to interest on dividend accumulations on unmaturing life insurance policies.

In the case of interest on these dividend accumulations there would appear to be no need for exemption certificates because the interest is customarily left with the insurance company and not used by the policyholder to meet current living expenses.

In addition, the insurance companies, who recommend this change, have testified that the amounts involved are normally small and an exemption certificate procedure would be impractical to apply because of the millions of accounts.

Provision should also be made for exemption certificates to remain valid until revoked by the filer instead of requiring annual re-filing.

This would make the House exemption certificate system easier to administer by the paying institutions and would also reduce the number of forms which nontaxable persons would be required to file.

There has been considerable exaggeration of the amount of over-withholding that could occur under the House bill. However, there may be some situations where the quarterly refund allowance is not sufficient to correct overwithholding on a taxpayer who happens to have large itemized deductions.

The House bill takes into account only the standard deduction in computing the allowable amount of a quarterly refund so that over-withholding can result if the taxpayer's itemized deductions exceed the standard deduction.

In order to provide prompt refund of all significant overwithholding, we would recommend extension of the refund allowance provision to permit an individual to take into account his itemized deductions, if he so desired.

We also recommend two changes to eliminate technical problems which have been called to our attention. The first is to eliminate withholding on dividends in kind which consist of distributions of stock of another corporation.

Second, it has been pointed out to us that some corporations, for instance, some railroads with little or no tax liability may not be able to file their final tax returns until many months after the close of the taxable year.

Such corporations would be delayed in obtaining a refund of amounts withheld from their interest and dividends since under the House bill refund for the fourth quarter of the taxable year can only be obtained upon the filing of the final return for such year.

This problem can be solved by permitting a quarterly refund for the fourth quarter in the case of a corporate taxpayer if the refund is expected to exceed its total tax liability for the year.

These changes will all reduce inconvenience both to payors and recipients of interest and dividends and at the same time will maintain the effectiveness of the systems in reducing the intolerable gap between dividends and interest received and those reported for tax purposes.

#### CONTROLLED FOREIGN CORPORATIONS (SEC. 13)

A great deal of concern has been expressed by witnesses regarding the provisions of section 13 of the bill. Substantial modifications of this section are called for.

We remain convinced that our basic proposal for the general elimination of deferral for operations in developed countries would be the most equitable and appropriate policy.



Adoption of this principle would eliminate a great deal of the complexity of section 13.

However, should the committee decide to adopt an approach along the lines of the House bill, there are a number of changes that should be made. Our suggestions for such changes should not be taken as indicating any lessening of our support for the elimination of deferral.

It merely seemed desirable to indicate the changes that would be needed to improve the working of section 13 should this type of approach be preferred by the committee.

#### A. SUGGESTIONS AS TO INCOME COVERED IN SECTION 13

1. Change approach to income from U.S. patents, copyrights, etc.: The House bill deals with the problem of U.S.-developed patents, copyrights, and exclusive formulas and processes, which are exploited abroad free of U.S. tax by controlled foreign corporations, by subjecting the current income generated by such rights to current U.S. taxation.

This requires a determination of the amount of income generated by the use of patents, etc., an admittedly difficult problem. It would be more appropriate to handle this problem at the time the patent (or any like property or right) is transferred abroad.

Thus, it could be provided that the sale of such a U.S.-developed patent to a controlled foreign corporation would result in ordinary income, rather than capital gain, as frequently occurs under present law.

A somewhat longer statute of limitations could be provided to insure that the valuation of the patent at the time of transfer is a fair one.

If the patent is licensed rather than sold, the transferee of the patent is under current law obligated to pay a fair royalty annually in return for the use of such patent.

This approach should effectively eliminate any abuse in this area since all U.S. patents would be transferred abroad in arms-length transactions producing a full U.S. tax at the time of transfer or on an annual basis.

It would make unnecessary the determination of the amount of income generated by the use of patents, etc., as under the House bill.

2. Refine coverage of foreign-base company provisions: The coverage of the foreign-base company provisions of section 13 should be modified to insure that all tax-haven transactions are reached and also to avoid unintended coverage of non-tax-haven situations.

Thus, the omission under H.R. 10650 of income received by tax-haven companies from related parties for rendering managerial, technical, and other services outside of the country of their incorporation should be corrected since this is a significant form of tax-haven income.

Also, the coverage of tax-haven sales income requires technical clarification to insure its application to commissions of companies acting as sales agents.

On the other hand, the base company provisions of section 13 now treat certain kinds of actual operating income as passive income and, therefore, subject to taxation to the U.S. shareholder.

Thus, rentals, royalties, and interest may constitute active income to businesses such as shipping, leasing, and financing companies.

These types of income when they are the income of an operating company should not be treated as "passive income," and, accordingly, an appropriate exception should be made.

However, this exception should not extend to tax-haven situations, as for example, when rentals are received from a related party for the use of property outside of the country of incorporation of the recipient.

We would also suggest that there be an overall exception to deal with situations where a controlled foreign corporation covered by the provisions of the bill has not been availed of to avoid taxes. Such a provision was contained in the revised draft of tax-haven legislation which we submitted to the House Ways and Means Committee, and we feel it would be desirable from the standpoint of adding flexibility to insure a fair application of the base company income provisions in the cases where it is needed. For example, a subsidiary incorporated in one country but conducting a sales operation in a second country may pay full taxes to the second country so that its place of incorporation does not result in the avoidance of taxes. Finally, there are certain shipping activities which present special problems for which exclusions should be developed.

3. Limit antidiversification rule: The House bill denies the use of deferral to new businesses in developed areas. Earnings invested in a trade or business that was not in operation on December 31, 1962, or that has not been in operation for 5 years would not qualify for deferral. Our preference that deferral be eliminated for all profits arising in developed areas, of course, would obviate the need for this provision. However, if deferral is not eliminated, the provision should be modified to make clear that it applies only with respect to the use of earnings from a business presently enjoying deferral and that it does not apply to the earnings of a new business started with fresh capital from the United States. Also, it may be desirable to indicate with more definiteness when a trade or business will be considered to have been conducted for a 5-year period or since December 31, 1962, by substantially the same interests.

4. Eliminate provision for reinvestment of developed area tax haven profits: I renew my prior suggestion to modify the deduction for reinvestment in less developed countries to prevent a "pour over" from developed countries. Permitting the profits of tax haven companies in developed areas to escape U.S. taxation might unduly encourage the use of such tax haven companies and would be inconsistent with the basic policy of eliminating deferral for such operations.

Our view is that the soundest approach would be to provide that there would be no reinvestment deduction for any tax haven profits except for dividends and interest derived from related companies carrying on an active trade or business within a less developed country.

In this connection, I would suggest liberalizing the types of property which would qualify for the deduction as well as the conditions for reinvestment. For example, it may be that substantial minority stock interest should qualify even though the foreign corporation is not U.S. controlled.

Consideration should also be given to allowing certain forms of debt obligations to qualify. The time within which investments must be

made is much too restricted under section 13 and provision for a longer period would be desirable.

5. Liberalized rules for reinvestment of earnings of operating companies in less-developed areas: As a concomitant of my last suggestion, I would propose to liberalize the use to which earnings of operating companies in less-developed countries may be put. I recommend that there be complete freedom as to the manner in which such earnings may be employed. To insure that this privilege is only granted in appropriate circumstances it will be necessary to restrict the companies qualifying to those having substantially all their income from such countries. In this connection, liberal rules as to source of income would be provided, so that such companies can market their products or purchase materials outside less-developed countries and still qualify as operating in less-developed areas. It should be pointed out that operating companies not qualifying for the less-developed country reinvestment privilege would have restricted reinvestment privileges regardless of where their earnings were reinvested.

6. Nonapplicability to possessions of United States: All corporations not incorporated under the laws of the United States are treated as foreign corporations for purposes of the Internal Revenue Code. As a consequence, corporations incorporated under the laws of possessions of the United States technically might be classified and treated as controlled foreign corporations under the present language of the bill. I would recommend, however, that such corporations not be treated as controlled foreign corporations, since the possessions of the United States, principally Puerto Rico and the Virgin Islands, are not truly foreign areas and present special problems under U.S. tax law which can best be handled outside of the context of the treatment of controlled foreign corporations.

#### D. SUGGESTIONS WITH RESPECT TO TECHNIQUE

1. Modify definition of controlled foreign corporation: We recommend modifying the definition of control so as to limit somewhat the coverage of foreign corporations classified as controlled foreign corporations. Perhaps the most effective way of doing this would be to provide that in determining whether more than 50 percent of a foreign corporation is owned by U.S. persons, only U.S. shareholders owning at least a 10 percent interest are to be counted. This would eliminate, for example, the possibility of covering certain foreign corporations more than 50 percent of which may be owned by U.S. persons but where such ownership is so widely scattered that there is no U.S. group in effective control. Also, some modifications in the constructive ownership rules would seem desirable to achieve a more limited coverage. In particular, we would recommend that U.S. shareholders not be treated as the indirect owners of stock owned by a corporation in which they have an interest unless such interest is at least 10 percent.

2. Recognition of losses: It would seem desirable to provide for greater recognition of losses of foreign subsidiaries than is effected by the House bill. Thus, some provision should be made for allowing losses of a foreign subsidiary in 1 year to offset its profits for another

year which otherwise would be taxable under section 13. It would also seem desirable to make certain changes in the mechanics for taxing constructive distributions to U.S. shareholders. Some of these changes would enable the losses of intervening foreign corporations to offset the gains of subsidiaries of such controlled foreign corporations.

3. Computation of earnings and profits: Some concern has been expressed over the problem of computing the earnings and profits of a controlled foreign corporation that would be taxed to U.S. shareholders. We shall provide clear administrative regulations to assist taxpayers in computing the earnings and profits of foreign corporations in accordance with the rules which have been developed for domestic corporations. We will permit the foreign corporations earnings and profits to be computed with the benefit of elections similar to those which are available to domestic corporations.

4. Foreign currency restrictions and blocked income: We are aware of problems taxpayers have with foreign currency restrictions and blocked income and provisions should be made to take care of these situations. These problems arise under present law in connection with branch operations and administrative guidelines have been developed in the past to deal with them. Problems under the House bill will be somewhat different than those dealt with in the past but it is believed that these matters can be handled satisfactorily through establishment of rules which are similar in nature.

5. Reorganizing foreign corporate structures: Taxpayers have indicated a desire to reorganize foreign corporate structures to accommodate to the legislation. I would like to state that it would be the policy of the Treasury to view sympathetically applications of taxpayers for rulings under section 367 which are required in the case of reorganizations involving foreign corporations. We contemplate that such advance rulings could be made available relatively freely, except in situations where such arrangements involve U.S. tax avoidance.

#### LIQUIDATION PROVISION (SEC. 16)

In my prior testimony, I suggested reconsideration of section 16, dealing with the liquidation of or sale of stock in controlled foreign corporations. The hearings and discussions with private groups have confirmed our view that this provision should apply only to earnings for taxable years beginning after December 31, 1962. In addition, technical amendments are needed to coordinate more closely the treatment of sales of stock with the treatment on liquidation, including the allowance in appropriate circumstances of a foreign tax credit on sales of stock.

Further, we recommend that the impact of the section on individuals be mitigated. Unlike a corporate shareholder, whose tax will be limited to 62 percent less a foreign tax credit, the individual would be taxed at rates up to 91 percent and no foreign tax credit would be available. Two meritorious suggestions have been advanced. The first would add an averaging provision to the bill. This would be similar to that involved in the foreign trust provision, which per-

mits an individual to reduce the amount of tax on a distribution by treating it as if it had been distributed to him over the period of his holding. The second would give the individual shareholder the alternative of limiting his tax under section 16 to a capital gains tax, provided that at the same time he pays a tax equal to 52 percent of the earnings of the corporation less any foreign tax credit. The mechanics of this will work out so that the shareholder pays 64 percent overall (52 percent plus 25 percent of 48 percent) and is in exactly the same position as if he had had a domestic corporation which had paid its full 52-percent tax and which he had liquidated or sold at capital gain rates.

#### INFORMATION REQUIREMENTS (SEC. 20)

Section 20 of the House bill needs some modification. For example, changes are needed to prevent the provision from applying to foreign corporations where there is no substantial U.S. share ownership. It should be made clear that U.S. officers and directors of foreign companies where there are no substantial U.S. owners need not supply information as to such companies. Likewise, it should be provided that domestic subsidiaries of foreign parent corporations will not be required to supply information about non-U.S. subsidiaries of such parent corporations. Finally, it should be made clear that as to all aspects of section 20 information will be required only as set forth in such regulations as are in existence on the first day of a taxable year.

#### FOREIGN INVESTMENT COMPANIES (SEC. 15)

Further study of the foreign investment company provisions with representatives of such companies indicates that a number of minor technical amendments should be added to clarify and improve their application. For example, an increase should be made in the time permitted for reporting undistributed capital gains to the shareholders. Also, provision should be made for a passthrough of foreign tax credit to the shareholders for taxes paid by the foreign investment company.

Finally, with respect to the overall problem of foreign income, I believe that the hearings have shown more than ever the need for and the appropriateness of legislation to establish equity in the taxation of such income and I hope that the committee will agree with this view and act accordingly.

#### CONCLUSION

In conclusion I wish to express our appreciation for the extended effort and careful consideration which your committee and those testifying before it have already given to this legislation. As your consideration of the bill progresses, we are at your disposal to work further with you and your staffs in any which you feel may be helpful to you.

Thank you, Mr. Chairman.

I would also like to submit a revised memorandum and table to replace materials which we submitted earlier and which appeared at pages 450 to 452 of part 1 of the committee hearings. This material

shows "Total Tax Collections as a Percent of GNP and National Income, the United States and Foreign Countries." I believe it would be desirable to have the revised material, which corrects some errors in the earlier submission, placed in the record.

(The material referred to follows:)

**TOTAL TAX COLLECTIONS AS A PERCENT OF GNP AND NATIONAL INCOME, THE UNITED STATES AND NINE FOREIGN COUNTRIES**

Attached is a table showing total tax collections as a percent of gross national product and national income, in 10 countries. The ratio of income and wealth taxes to total taxes and to national income is also shown. This table is based on data from national account statistics, compiled by the United Nations. The definitions of terms used in the table follow:

(1) Gross national product is equal to the market value of the product before deduction of provisions for the consumption of fixed capital.

(2) National income is the sum of income accruing to factors of production before deduction of direct taxes.

(3) Total taxes shown in the table include indirect and direct taxes on corporations, households, and nonprofit institutions.

(4) Income and wealth taxes include direct taxes on corporations, households, and private nonprofit institutions. Social security contributions of both employers and employees are included in direct taxes. Excluded from income and wealth taxes are taxes on goods and services which are chargeable to business expense and taxes on the possession or use of goods and services by households. Examples of such taxes are import and export duties, sales taxes and motor vehicle license fees. Real estate and land taxes are included in indirect taxes (and hence are excluded from income and wealth taxes) unless they are considered administrative devices for the collection of income taxes.

This table shows that the ratio of taxes to GNP and national income is higher in six countries than in the United States. Only in Belgium, Canada, and Japan are taxes a smaller proportion of GNP or national income. The United States, Sweden, and the Netherlands derive the highest proportion of their taxes from income and wealth taxes. The ratio of income and wealth taxes to total taxes in the other seven countries is considerably lower than in the United States.

The Netherlands has the highest ratio of income and wealth taxes to national income, followed by Germany, Sweden, and the United States. These countries are followed by France, the United Kingdom, Italy, Belgium, Canada, and Japan, in that order.

These rankings differ sharply from those shown in the last two columns of the table, taken from the September 1961 issue of the First National City Bank letter. As the figures in column 9 show, when central government tax collections alone are taken into account, the United States has the highest ratio of taxes on income and capital to total tax collections. This country derives 86 percent of tax revenue from these taxes while Canada, the next highest ranking country, derives only 60 percent of tax revenue from the same sources. (Income and profit taxes, death duties and estate and gift taxes are included in taxes on income and capital.)

The ratios shown here are less significant than those shown in column 8. This is so for two reasons. In the first place central government revenues alone are considered. In the United States State and local governments rely heavily on indirect taxes while the central government relies primarily on direct taxes. In many countries the central government collects the indirect taxes levied in this country by local government as well as individual and corporate income taxes levied primarily by the central government in the United States.

Secondly, the comparison of income and capital (or income and wealth) taxes to total taxes is less meaningful than the comparison between those taxes and national income. The former gives no indication of the rate structure of taxes nor of their incidence. The latter shows what proportion of the income earned by factors of production is left to their own disposal. Although taxes on income and wealth as a percent of total taxes are higher in the United States than in West Germany, the ratio of income and wealth taxes to national income is higher in Germany than in the United States.

Total tax collections as a percent of GNP and national income, 1959 (includes State and local taxes)

Country	(1) Taxes as a percent of GNP	(2) Rank	(3) Taxes as a percent of national income	(4) Rank	(5) Income and wealth taxes as a percent of total taxes	(6) Rank	(7) Income and wealth taxes as a percent of national income	(8) Rank	(9) Taxes on income and capital as percent of central Government tax revenue <sup>1</sup>	(10) Rank
Belgium.....	23.1	9	31.1	9	59.0	4	18.3	8	39	7
Canada.....	24.3	8	32.1	8	48.7	10	15.0	9	60	2
France.....	33.3	2	44.2	1	48.2	9	21.3	5	31	8
Germany, F. R.....	33.4	1	43.0	2	54.5	5	23.4	2	22	10
Italy.....	29.0	5	37.0	3	51.8	7	19.2	7	26	9
Japan.....	19.0	10	23.8	10	49.9	8	11.9	10	51	6
Netherlands.....	29.1	4	35.4	5	66.5	1	23.5	1	54	3-4
Sweden.....	29.7	3	32.6	6	66.0	3	21.5	3-4	53	5
United Kingdom.....	28.9	6	36.2	4	53.4	6	19.3	6	54	3-4
United States.....	26.7	7	32.5	7	66.2	2	21.5	3-4	86	1

<sup>1</sup> 1960 data.

<sup>2</sup> In the United Nations source, social security taxes for Italy are not included. These data were obtained from Foreign Service Dispatch No. 1150.

<sup>3</sup> Estimates of national income include provisions for the consumption of fixed capital; the total shown therefore relates to gross national product at factor cost rather than national income.

<sup>4</sup> The U. N. Yearbook of National Account Statistics gives total U. S. tax collections for 1959 as \$129,091 million. This includes \$43,646 million for indirect taxes and \$85,445 million in direct taxes. The Survey of Current Business, July 1961, has total tax collections in the United States for 1959 as \$124,635 million, including \$83 billion of direct taxes and \$42 billion of indirect taxes. Non-tax Government receipts and Federal grants-in-aid to the States have been omitted from this total. Using the Survey of Current Business figures, total tax collections in the United States are 25.8 percent of gross National product and 31.4 percent of national income. Income and wealth taxes are approximately 66.4 percent of total taxes and 21 percent of national income.

Sources: (1) United Nations, Yearbook of National Account Statistics, 1960; (2) German tax data from Deutsche Bundesbank, Monthly Report, January 1961; German social insurance data from Agency for International Development Economic Data Book for the Countries of Europe, table D-2; (3) Column 9 from First National City Bank, Monthly Letter, September 1961, p. 100.

The CHAIRMAN. Thank you, Mr. Secretary.

As the Chair understands it the recommendations you make this morning are in addition to the recommendations you made with respect to the House bill when you first testified.

Secretary DILLON. That is correct, Mr. Chairman. These are in addition. Except as modified by these recommendations which I made today, all the other recommendations we made in our original statement stand.

The CHAIRMAN. And the committee is to consider that in the statements you have made today you have modified to some extent the recommendations of your first appearance.

Secretary DILLON. That is correct.

The CHAIRMAN. As the Chair has announced, Senators who didn't have an opportunity to examine the Secretary when he was here before will be called first.

The Chair recognizes Senator Long.

Senator LONG. Mr. Chairman, I want to thank you for the application of that Biblical rule, the last shall be first. I regret I couldn't have been here at the previous meeting.

Mr. Secretary, I believe that there was some undue alarm among some of the business community about your statement on April 2 when you asked for a change in the rules for computing the tax credit on foreign investment income.

You cited a flow of short-term funds to Canada and I believe you are correct in what you recommended with regard to that.

According to your testimony contained on pages 103 and 104 of the record, and in greater detail at page 243, this change is intended to cover short-term investments abroad.

Am I correct in my understanding you do not intend this change to apply to dividends received by a U.S. corporation from another corporation, domestic or foreign in which it owns at least 10 percent of the voting stock?

Secretary DILLON. That is correct. No, it would not. It is only meant to handle this one specific short-term problem which I described in my April 2 statement.

Senator LONG. Would I also be correct in understanding that you do not intend this change to apply to interest received from investments in such affiliates?

Secretary DILLON. No, it would not apply to interest received from such affiliates.

Senator LONG. Now, do you intend this change to apply to interest received on a loan made to a foreign customer to secure an outlet for products to be sold to the lender?

Secretary DILLON. No. This was only meant to apply, in effect, to passive funds that were transferred abroad for the specific purpose of taking advantage of this situation in the law where there is an unused credit which allows totally tax-free treatment of the income from such passive funds by investment abroad.

Senator LONG. I have been informed by some corporations occasionally that they are required to buy bonds in a Latin American country. They are not particularly anxious to buy them, but while they have no enthusiasm for the purchase, as a matter of good will in the country they are more or less compelled to do so.

And I take it that you would not intend your recommendation to apply to that either?

Secretary DILLON. No.

Senator LONG. As long as it is limited to that, I think the recommendation should receive complete support. At least I would expect to support it.

Now, I would like to know how you believe this bill will affect the ability of American companies to do business within the Common Market?

Secretary DILLON. It is our feeling that this bill should not have any major effect on the ability of these companies to do business in the Common Market.

We have to look at this in two ways: First, there is our recommendation that there be complete elimination of deferral in developed countries. This would mean that our companies operating in the Common Market would have to pay somewhat higher taxes in a number of countries than their competitors. In the largest of these countries, the statutory tax rates are close to or equivalent to ours, although I understand that the effective rate actually paid is generally less abroad, so that even in those cases there would be still some additional taxes due.



We don't think that this extra tax on profits, which would not be large—a difference, on the average of between 40 to 45 percent, and 52 percent—would really make any very serious difference.

Now, the other aspect of the bill is the tax haven aspect, and there again we feel that this should not cause any real problem because although a few foreign companies do make use of tax havens, this very widespread use of tax havens is essentially an American phenomenon. If American companies could not use them, they would just be put on a more or less equivalent basis with most of their foreign competitors.

Senator LONG. I am frank to say, Mr. Secretary, of all the protests I have heard on various aspects of this bill, I haven't heard the first complaint about the sections in this bill designed to strike at tax havens.

As a matter of fact, I think even some corporations which are taking advantage of tax haven situations freely concede that the loophole should be closed and I congratulate you for your activities on that part of the bill.

But there are some Americans who feel that they are already at something of a competitive disadvantage in dealing in the Common Market because those countries tend to favor their own corporations and that they would be at an even greater disadvantage as a result of this bill.

I believe that you have also heard at least some expression of such an opinion.

Secretary DILLON. In general, yes. But I am not aware of any case where those countries favor their own companies as against a foreign-owned subsidiary, say an American subsidiary, operating within their country, so I don't think that they are at a disadvantage now at all.

I think many American companies, because of their greater use of tax havens than is the case with their foreign competitors actually have a certain advantage now.

Senator LONG. Now, there are some of those American corporations who feel that they are making about a 20-percent profit dealing in the Common Market countries. While you may feel you are improving your balance-of-payments situation with this bill, these corporations believe insofar as you discourage Americans from investing that, in the long run you are going to make your balance-of-payments situation worse rather than better. This is based on the theory that while in the short run they would tend to upset your balance of payments, in the long run those investments would help the balance of payments.

I wonder what your reaction to that is?

Secretary DILLON. Well, I think it certainly is true that no American company would make an investment overseas unless it felt it was going to make a profit. The only time it would be wrong is when there is a mistake in business judgment and it doesn't turn out.

And certainly in the long run they would tend to bring profits back to the United States to let their shareholders share in those profits.

The real problem that we face from the balance of payments point of view is demonstrated by the best study we can make of this situation, which was contained in exhibit III accompanying my earlier statement.

I haven't heard any testimony that convinced me there is anything wrong with it. In fact there has been very little testimony opposed to it. This study indicates that it would be some 12 or 15 years after current investments were made before the return flow would compensate for the investments. Therefore, we are and would in balance-of-payments difficulties for that period.

The fact is that we have our balance-of-payments troubles now, not 10 years from now. That is why we think that this change would be helpful now from the balance-of-payments point of view. I think that is one of the very important reasons supporting this particular proposal.

But I certainly concede that over a very long period of time investment should help the balance of payments.

The fact of the matter is that today we have about \$50 billion in oversea investments, direct and other; and we are receiving from that about \$3 billion a year in interest and dividends. But we are reinvesting just about the same amount each year, so that we are not getting at the moment any net plus factor from our balance of payments out of that already very big investment.

Senator LOISE. It has been argued that while it is true that the tax, the immediate taxation of these profits, would tend to encourage a return of the profits to the United States rather than the leaving of them over there, that by the same token it would discourage the investment of those funds over there which in many cases would make it more difficult to merchandise American products.

In other words, there are a lot of the investments over there in these foreign countries, which are investments in sales outlets and distributorships and various and sundry undertakings to sell American-made products.

Do you recognize that to some extent this might discourage investments which help to increase the flow of American products into those markets?

Secretary DILLON. Possibly.

The figures in the very careful study in exhibit III that was made on this point indicate that, as I recall it, for every dollar invested in Western Europe at this time we get a continuing flow of exports of one kind or another worth about 8 cents a year. I have heard no criticism of these figures.

So, it is not a very big amount, and in addition, there is indication that this dollar creates a certain amount of imports into the United States which would further reduce that 8 cents.

So, while there may be some net flow, it is not as large as it has been portrayed.

Now, again, these same figures, which are all Department of Commerce figures, show a totally different situation when you talk about underdeveloped country investment because there a dollar invested, creates an annual flow of exports from the United States of somewhere between 40 and 50 cents. This is natural, because in the underdeveloped countries they don't have available the spare parts, the semi-manufactured materials and the various other things that are needed to run the business, so they have to get them from the United States, whereas in Europe they are available, so they get them there.

Senator LONG. I would like to direct your attention to the entertainment sections of the bill, and those start on page 27, and they go through page 31, on through page 32.

This section starts out with a general rule, and ---

Secretary DILLON. I am just getting a copy of the bill.

Thank you.

Senator LONG. And incidentally, I would welcome any assistance you might want from your staff on this because I think this is not an easy question to answer.

I would like to have as full an answer as I can obtain to it. It starts out with a general rule, on page 27:

No deduction otherwise allowable under this chapter shall be allowed for any activity with respect to an activity which is of the type generally considered to constitute entertainment, amusement, or recreation unless the taxpayer establishes the item or that the item was directly related to the active conduct of the taxpayer's trade or business.

Now, that is the general rule, as I understand it.

Secretary DILLON. Right.

Senator LONG. If he can establish that entertainment was directly related to the conduct of his trade or business then it would be deductible. Then you come down to the specific exceptions on page 30.

Now, these are exceptions that would clearly be deductible and it includes business meals, food and beverage for employees, expenses treated as compensation, and recreation expenses for employees and reimbursed expenses, employee and stockholder business meetings, meetings of business leagues, et cetera, items available to the public, entertainment sold to the public, and interest, taxes, and casualty losses.

What I would like to know is what illustrations can you think of or can your staff give us as illustrations here of items that would be covered by the general rule, items of entertainment covered by the general rule which are not contained in the specific exceptions.

Secretary DILLON. Well, this would apply, as a general rule, I think, to the great bulk of entertaining.

When you entertain either customers or would-be customers, or people that you think would have some connection with getting business—which is the general type of thing that the abuse consists of—that sort of entertainment would be covered completely under the general rule.

The special rules were only designed to cover such things as, say, food and beverages for employees, where you have a cafeteria, in a property or factory where you serve your employees regularly. You might have a man come in and eat lunch there where a lunch costs 60 cents. It didn't make any sense to disallow that.

The other specific exceptions are similar. The most important one is the business meal. We believed there should be an exception in the frequent case where individuals who are conducting business negotiations go out to lunch or dinner together. They may have been negotiating all morning or afternoon in the office, they adjourned to some place for a meal, and they continue their talks in an atmosphere where they can continue them. We feel that that should be a deductible expense because it is truly business in character.

But any other kind of entertaining would come under the general rule, including theater tickets, night clubs, meals that are not in the

business discussion area such as where you have big cocktail parties—things of that nature.

Senator LONG. Mr. Secretary, I have given a lot of thought to this problem and I guess I have voted on both sides of the entertainment rule so I guess I can get into the position of really seeing both sides having voted both ways [laughter], and frankly, the one thought that occurs to me about this is it seems to me as though it might be quite an imposition to insist that for a person to be able to deduct a business meal he must have discussed business at that time.

Now, just to give you a personal example, I can recall one time when a fellow was worried about the minimum wage affecting his business and he invited my wife and I out with him and I thought he was going to drive me wild talking about that matter, and I hope I never saw him again.

That is a poor way to entertain when people badger some poor fellow and drive him wild talking all night about their problem [laughter]; it seems to me as though they would do much better to generate some good will and then at an appropriate time bring the matter up.

Now—[Laughter].

Senator GORE. Will the Senator yield?

Senator LONG. Yes.

Senator GORE. Let's pass a Senatorial rule. [Laughter.]

The CHAIRMAN. Would the Senator indicate how it is going to generate that good will? [Laughter.]

Senator LONG. Is it really the intent of this bill that for a person to be able to deduct for entertainment he actually has to get a fellow in the corner and talk to him about his business at a particular meal where he is entertaining?

Secretary DILLON. No, specifically not.

The business meal provision talks about surroundings and type of a meal, in other words, that you have businessmen at it; it is the type of place that the people you are talking to are people that you actually do business with.

In the report of the Ways and Means Committee, which clarifies this, there is the flat statement that there is no requirement in this exception that business actually be discussed, because obviously it would go too far to try to have a person keep a record of exactly what he said at every meal. The same group of business people literally may have, as I said, discussed business all morning at a conference, moved across the street and taken an hour's break, and then came back to work again without discussing business at lunch.

That should be deductible as part of the whole thing.

Senator LONG. I know as a lawyer that the general rule is that lawyers are not to solicit business.

A fellow, for example, can't put an ad in a newspaper. He can send out a lot of announcements that he is going into business. But the most successful lawyers find ways of very subtle solicitation, that has been my opinion, even though they are not supposed to solicit.

For example, when a fellow happens to know the manager of a corporation that is going to be doing business in his area, if he has any excuse at all to meet him socially, the first minute that manager steps off the airplane the lawyer is out there to receive him and be of help to him if he can.

And while lawyers might deny that they are soliciting at that point, as a matter of fact, they are, they are looking for business. And do you recognize that that is part of the expense of doing business?

Secretary DILLON. I spent many years in the investment banking and brokerage business and they have to get business, too. I think there is a great similarity in the way this is done.

But we felt that there are certainly abuses here and a line had to be drawn somewhere. The clearest place to draw the line is where there is entertainment of a type which is personal, where the fellow giving the entertainment gets some personal pleasure out of it, and the person being entertained does also, at the expense of the Government.

We don't consider a meal to be a problem—that is an ordinary thing. But when it comes to going to a prize fight or something like that, we just don't feel that the Government should be required to bear the freight of paying for the tickets. That is the theory behind this thing.

Senator LONG. Of course, the Government wouldn't be bearing the freight of paying for the tickets if it didn't have the rate so high that the Government is the big partner with the other fellow getting the small end.

If the man was more than a 50-percent partner with the Government he would be bearing his own freight, it seems to me, and sometimes I think that might provide a better answer.

Secretary DILLON. Well, all these problems are affected, of course, by the very high rates of personal income tax presently existing.

Senator LONG. I hope one of these days we will have a recommendation from you that we have reduction in those upper rates. It wouldn't cost much, and it would, I think solve a lot of your problems of people who spend more time worrying about taxes than they do worrying to make their businesses succeed.

Secretary DILLON. We have stated we intend to do that next year, and the President has so stated.

But we stated that when we do make that recommendation we feel it should cover the whole income tax structure from top to bottom.

Senator LONG. As you know there have been quite a few of these witnesses who have testified that they find it difficult to reconcile the language of the bill with the House committee report with regard to entertainment expenses and obtaining good will.

What is your attitude with regard to entertaining customers at theaters, night clubs, ball games, and matters of that sort?

Secretary DILLON. Well, I think under the committee report those types of things would be disallowed. Of course, it was our original view that they should be disallowed.

The difficulty is in writing general language. This was discussed at great length in the House committee, and it was agreed by all concerned that if you wrote general language such as this into the law, the language could be interpreted in all sorts of ways and would lead to all sorts of conflicts. Accordingly, it would be necessary and very important to have a committee report that rather clearly set out what the intent of the committee and the Congress was at that time.

And I would think, if this method is followed rather than the method we originally suggested, that so far as the Senate committee's report is concerned it ought to be equally specific.

Senator LONG. It seems to me, Mr. Secretary, that a lot of this entertainment should properly depend upon what is expected or what the general practice in the trade or profession happens to be and a lot of it would have to depend on the circumstances.

If a fellow came to Baton Rouge, La., where I practice law, even if he was one of my best clients, I wouldn't expect, he wouldn't expect me, to take him out to a theater.

For one thing, we don't have a theater. (Laughter.)

But if I were a successful New York businessman who had had the good fortune of getting a number of contracts with a major corporation, and some fellow from that corporation visited New York and I knew him on a personal basis, it seems to me it would be sort of expected that I should take him out to a New York play and try to find some tickets for that play.

I am sure you have experienced some of the same problems with regard to some of your clients in business, haven't you?

Secretary DILLON. Right.

Senator LONG. Thank you very much, Mr. Secretary.

Secretary DILLON. Thank you.

The CHAIRMAN. The next Senator is Senator Bennett, who has not yet examined the Secretary.

Senator BENNETT. Good morning, Mr. Secretary.

I apologize for being late. I have been at another hearing and I am a little out of breath.

Mr. Secretary, after we finish with the tax bill, we will be taking up the President's trade program. It seems to me in many respects these two bills will have exactly the opposite effect.

By the trade bill we are encouraging American businesses to look abroad. By the tax bill we are saying, "If you do go abroad, we will tax the dickens out of you."

Throughout these hearings, I don't think we yet have a satisfactory explanation of the manner in which these two programs can work together for the advancement of the American economy.

Would you like to comment on this apparent contradiction?

Secretary DILLON. Yes, I think the contradiction is more apparent than real. In the trade bill we are talking about the exchange of goods, which is what trade is in the world. We try trying to build up our exchanges of goods with foreign countries, trying to increase our exports. We know that with that will go an increase in imports, but we think that, on the whole, we will benefit by that, and have more of an increase in exports than we will have in imports.

Movements of capital are somewhat different. All we are trying to do here is to remove the special tax inducement that now exists for investment in developed countries overseas.

There are no special inducements for exports. We haven't thought of doing that, and in our tax recommendations we are not trying to put roadblocks in the way of investment.

We think, and our estimates show, that even with the enactment of this bill there will be very substantial foreign investment which will continue, and we think it should continue.

We think that there isn't any conflict. In fact, there are some reasons why the two would go quite parallel, because as you reduce tariffs to very low levels the local costs of doing business, including

taxes, become more important. In the trade bill one section indicates, in particular with respect to the Common Market, that under certain circumstances tariffs might be reduced all the way down to zero. Without an equality of tax treatment, I would think as we reduced tariffs, there would be a tendency for business here to move abroad and manufacture abroad for the American market.

I don't think most of the investment that has gone overseas so far has involved manufacturers for the American market. There has been talk about it, and seem of it has been done, but I think a very small amount. But certainly if you had a situation where there was almost equivalence and no taxes or very low taxes, there would be much greater inducement to manufacture abroad for the American market, if it was felt that the taxes over there were much lower.

Senator BENNETT. Well, many of the witnesses who have appeared before the committee, representing American companies with foreign subsidiaries abroad, have testified that the presence abroad of their foreign subsidiaries has substantially increased their ability to export items in their line which are manufactured in the United States, and the inference is if the tax burden put on the foreign subsidiaries interferes with their ability to sell their products, this will have a backup effect on the products they manufacture in the United States.

I have the impression that many of them feel that this tax bill will actually reduce their ability to export American-made goods. Do you have any comment on that?

Secretary DILLON. Well, certainly, the last thing in the world we want to do is to reduce the ability of our companies to export because we want to increase exports. That is one of the reasons for the investment incentive credit in the bill—lower costs make it easier to export.

But I did comment, I think, earlier, on the only overall figures we have on this question. I don't take any exception to what any individual witness may have said about his own company. But the only overall figures are those in a study made by the Department of Commerce in some detail. We have analyzed those figures in great detail. The results are in the exhibit III to my original statement. They indicate that for every dollar that we invest in Europe the amount of exports that they generate from the United States on an annual basis is about 8 cents. This is not a large amount.

Whereas investment in underdeveloped areas generates five times as much, because there they have to come back to the United States to get their spare parts, and their semimanufactures and so forth. So it doesn't appear to us that the problem here is as large as it has been made out.

Also it ties in particularly here to the tax haven problem, and we think the record shows that many people who were exporting rather satisfactorily and then shifted their exporting activities to tax havens have not tremendously increased their exports as a result. But they have greatly reduced their taxes.

Senator BENNETT. This brings up the question of the proposed difference in tax treatment in proposed investments in underdeveloped countries to developed countries.

Didn't the Treasury first propose that all foreign profits of foreign controlled corporations, operating in developed countries, regardless of where invested, be taxed currently to the stockholders?

Secretary DILLON. In developed countries, yes.

Senator BENNETT. And then didn't you recommend that the present tax deferral be continued in the case of controlled foreign corporations operating in less developed countries?

Secretary DILLON. That has been the administration position. In answer to earlier questions, I said there is no particular tax logic to that policy, but it does take into account the overall policy objectives of other branches of the Government to help in the development of the less developed areas.

Senator BENNETT. Is it true, according to the bill, that before a business can qualify under the bill it must have been established 5 years or have been in existence since 1962?

Secretary DILLON. That is one of the changes. When I started today——

Senator BENNETT. I am sorry.

Secretary DILLON. I read a list of changes and I recommended that that be changed.

Senator BENNETT. How did you recommend that it be changed?

Secretary DILLON. That the 5-year period should not apply to any business started new from the United States.

That the only place where it should apply is in the case of a company which is already situated abroad, and which, taking advantage of deferral, uses the money on which it otherwise would have paid tax to start a wholly unrelated and new business. In that case I don't think it should be entitled to deferral. That is the only place where it applies.

Senator BENNETT. So that particular objection has been eliminated?

Secretary DILLON. Pretty much, I would say. I think that it was unintended in the original drafting.

Senator BENNETT. This wasn't realized when it was drafted?

Secretary DILLON. It wasn't realized in the drafting of that section. That section of the bill, I think you all realize, was drafted rather rapidly toward the end of the consideration in the House, and perhaps didn't have the same care as the other sections of the bill which had been under consideration in draft form for a much longer time.

Senator BENNETT. Turning then briefly to this gross-up provision. Is the impact of the gross-up provision lighter or heavier on income from the less-developed countries compared with the income from the developed countries?

Secretary DILLON. It is heavier on income from countries which have low taxes. Now, I have seen a number of statements, a good bit of testimony, that countries which have low taxes are underdeveloped countries, but that is not necessarily the case. Actually a country like India probably has higher corporate tax rates than almost any of the developed countries. So the impact would be nonexistent in the case of India, and there would be no effect. But to the extent that a country happens to have a lower tax rate, there would be more of an impact.

However, I think this is equitable, and it does not involve a very large amount. I think the existing treatment was probably originally arrived at through inadvertence in the law.

The basic law seems perfectly sensible. You are required to pay a 52-percent tax and you should get a foreign tax credit against it.



The way the original foreign tax credit provision happened to work out was a little different. If the foreign tax rate was 30 percent, you would wind up by paying a total of 45 percent instead of 52. We think there is no reason for this difference of 7 percentage points. We don't think anyone goes into an underdeveloped country because of that 7-percent difference in taxes, and, therefore, we feel that this provision should be changed.

I was rather surprised at the number of witnesses who testified before you on this subject. I think the situation was somewhat different in the testimony before the Ways and Means Committee, where there really wasn't any great objection to this proposal. I think there was realization that this was something that generally took a long time in coming and probably should come.

Senator BENNETT. Probably there was a greater awareness by the time the bill got over here?

Secretary DILLON. Maybe there was.

Senator BENNETT. Obviously, the tax systems of other countries are not uniform. That being so, can you say that the application of the gross-up formula will produce equality.

Secretary DILLON. Yes. That is exactly what it will do, because every American who gets income back will have paid 52-percent tax either to the foreign country or to his own country.

Senator BENNETT. But it might also be a part of the pressure on the part of the foreign country to raise its own corporate taxes to take advantage of the situation on the theory that the stockholder is going to have to pay it anyway and they might as well pay it abroad as here.

I would like to move over for a minute or two on this 75-day investment requirement.

Secretary DILLON. That was another thing which I in my statement said was much too short. It should be very considerably lengthened.

Senator BENNETT. But how much did you recommend that it be extended?

Secretary DILLON. I didn't make any recommendation as to the period of time. We felt that was something that could be discussed by the committee in executive session, but what we were running over in our minds was a period up to a year.

Senator BENNETT. This would certainly remove some of the objections. Just to make the point: Corporate taxpayers are permitted approximately 255 days—

Secretary DILLON. Right.

Senator BENNETT (continuing). In which to file their income tax return.

Secretary DILLON. Sure; that is why we felt this ought to be lengthened out considerably.

Senator BENNETT. Can you give the committee, or maybe you have already covered this, too, any information about the criteria on which you separate developed from underdeveloped countries?

Secretary DILLON. No; I did not cover that. However, the bill lists certain countries that are the developed countries, and it was our feeling that all the rest of them would be underdeveloped.

Senator BENNETT. This is just more or less arbitrary selection of countries that in the opinion of somebody at this time are considered to be developed?

Secretary DILLON. I think it is the list of countries that are generally considered to be developed in the sense that they are able to carry on their own affairs without any foreign aid or special help of that type.

Senator TALMADGE. Will the Senator yield at that point in order that I might ask a question relating to the same issue?

Senator BENNETT. I would be happy to.

Senator TALMADGE. How can you have stability in the area of developed or undeveloped countries without some criteria?

Secretary DILLON. Well, if the committee felt criteria were useful we would have no objection to putting criteria into the bill. We had felt that there was a general understanding that the countries that we aid in our foreign aid program are underdeveloped countries, and those which we find no reason to help are on their own and are no longer underdeveloped.

All of Latin America, for instance, under the Alliance for Progress, is underdeveloped, and this is a 10-year program. We would expect them to stay that way for at least that long. We would say all of Africa, with the exception of South Africa, which is listed in the bill, is underdeveloped and the same way with the Near East and with Asia.

I don't think in practice there is any very great difference. It certainly would not be our intent that there would be any rapid changes in the list of these countries, although I think the President has the right to designate them.

As you go along, there is a lot of talk that a country might be shifted one way or the other very rapidly from time to time on that. I don't think that would be likely to happen, because so far I haven't seen very many underdeveloped countries move out of that category into that of developed countries. I would be hard put to it to name one.

Senator TALMADGE. Do you have any criteria to suggest in case the committee wants to put it in the bill?

Secretary DILLON. No, not at this moment, but we could develop them.

I would like to work with the State Department on that, because they use this concept all the time.

Senator TALMADGE. It seems to me if some criteria are not written into the bill it would be subject to the administrative whim or caprice of whoever may make the decision?

Secretary DILLON. Well, if that is an objection, it is not a fundamental one as far as we are concerned. We would be glad to work with you and work one up.

Senator KERR. Would the Senator yield?

Senator TALMADGE. I would, except Senator Bennett has the floor.

Senator BENNETT. I will be happy to yield.

Senator KERR. I just wonder if a provision could be put into the bill that would fix it so that if a country is accepted as an undeveloped country in that category and becomes so identified, that the identification could not be changed until, say, after a 2-year period from a notification by the government of its not being in that category from and after some future date, or whatever would be adequate to protect those who had started their investments there, is that what the Senator had in mind?

Senator TALMADGE. It seems some criteria should be suggested or else you have no stability whatever as to what is developed or what is undeveloped.

A businessman who entered the country today might find it undeveloped today and developed tomorrow and vice versa.

Senator KERR. If they had designated it an undeveloped country and a businessman starts his investment there, he would know he would be protected for a period of time if they could not change it except from and after a day in the future of not less than 2 years, we will say, or whatever the appropriate time should be from the announcement of the Government that it would not regard it as an undeveloped country beyond or on and after a day not less than 2 years from the date of the announcements.

Secretary DILLON. We would have no objection to something of that nature, because certainly we don't want to put any road blocks in the way of investment in the underdeveloped countries because that is part of our national objectives at this time.

Senator TALMADGE. I thank the Senator from Utah.

Senator KERR. I thank the Senator from Utah.

Senator SMATHERS. Would the Senator yield at that point for one other question?

Senator BENNETT. Yes.

Senator SMATHERS. Mr. Secretary, I am sure you are aware that the President of the Republic of Panama sent a cablegram to the chairman of this committee and others stating that section 13 as now written and if adopted would be contrary to a treaty which the United States had entered into with the Republic of Panama. What is your feeling about that?

Secretary DILLON. It is our clear feeling, and we have checked this very carefully with legal counsel, that there is no inconsistency between this bill and any treaty, with one single exception which we pointed out. That is the estate tax treaty with Greece. That one we would have to renegotiate. We have also recommended that the provision in this bill, that is in the House bill, which said that the bill should override treaties, should be taken out of the bill so that it would not appear we are trying to override treaties, which we are not doing.

And we are certain on legal grounds that the President of Panama in this case is mistaken.

Senator SMATHERS. As I understand, what you are saying is that you are satisfied that it is not a violation or does not run counter to the treaty which has been entered into between the United States and Panama?

Secretary DILLON. That is right.

Senator SMATHERS. Thank you.

Senator BENNETT. Are you through?

Senator GORE. Will the Senator yield for one question on this point?

Senator BENNETT. Yes.

Senator GORE. Mr. Secretary, do not the mere questions and complications with respect to the differing treatment of developed and underdeveloped countries, demonstrate the difficulty, if not the inadvisability, of confusing tax policy with foreign policy?

Secretary DILLON. That is a very big philosophical problem, and certainly we would like to confuse the two to the least extent possible.

But in this particular case, it is an overriding policy of the administration, as it was of the previous one, to try to help encourage private investment in underdeveloped countries, and, therefore, we have in this bill gone along with that. But it certainly does make things more complicated from the tax point of view.

Senator SMATHERS. Would the Senator yield on that point again. I won't ask him to do it any more.

If a treaty in which the United States, and, we will say, country X had entered into, were more favorable and encouraged the development of private enterprise in that country, to a greater extent than this particular proposal we now have before us would do and if, as you state, you do not wish to abrogate a treaty, would you be willing for this committee to write into this legislation that it would in no way abrogate a treaty?

Secretary DILLON. Yes.

Senator SMATHERS. You would be willing to do that?

Secretary DILLON. Yes.

Senator BENNETT. Mr. Secretary, let's move into another phase of the foreign problem.

Under section 6 which has to do with the allocation of income and sales to and from a foreign corporation, I note you have excluded inventory and working capital of the foreign subsidiary as assets of the corporation in allocating the profit by the proportion of the resources of the corporation which contributed to the income.

In my opinion working capital and inventories are very important assets and it seems to me very unwise that these have not been included.

It is very possible that a corporation might have a very small amount of fixed assets and yet have a large total investment which must be maintained as long as the corporation operates.

Such a corporation might be very valuable in assisting the balance-of-payments problem because it has little export of capital and yet it could return considerable foreign funds and should be encouraged.

Are you trying to discourage companies that use up large amounts of dollar capital with small returns?

Secretary DILLON. No.

This particular formula I don't think is a matter of principle at all. What we were trying to accomplish there was to establish a formula which would remove from the present state of indecision the single most difficult situation in our tax code today.

There are more of our best revenue people tied up on this one problem than on any other single area in the code, because of the fact that section 482 as presently drafted is very vague.

And these are problems for business because businessmen don't know how to figure what the Government is going to ask them, how it is going to ask them to allocate. We were trying to get more definiteness in there.

Now, this particular formula was developed in the Ways and Means Committee by joint discussions between the Treasury and the professional staff of the Joint Committee on Internal Revenue Taxation, and if there are some errors with it, if there are some ways to improve it, we would be glad to accept those.

Senator BENNETT. You are not standing firm on this particular formula?

Secretary DILLON. On the particular formula, no. We do think that the formula is an advance and I think in general the great majority of business people would be inclined to agree with that, because it would give more certainty in this area.

Senator BENNETT. Now, one last question—moving into another field.

If we can tax the parent domestic company, tax the domestic company which is the parent of a foreign subsidiary on the consolidated earnings of the two companies or group of companies, what is to prevent a foreign company from requiring a similar consolidation when moneys flow through a subsidiary that is incorporated in that country, and then in turn placing a tax on the American part of the consolidation.

For example, if a Swiss company arranges a sale of goods from the United States into Germany, and then the goods are invoiced by the Swiss company, why couldn't the Swiss company require that both the U.S. and the German profits be consolidated and pay taxes on them?

Secretary DILLON. I imagine they could, and maybe that would be a fine solution. There wouldn't be any more tax haven in Switzerland; nobody would go there any more. [Laughter.]

Senator BENNETT. Yes, but on the theory that we are trying to get the effective American rate up on consolidations, wouldn't this then be an offsetting factor in calculating the American tax, if they taxed 52 percent on a consolidation basis, then there wouldn't be much left for us to tax.

Secretary DILLON. That is correct.

Senator BENNETT. And philosophically if we can tax a foreign corporation which is a subsidiary of a U.S. corporation by applying the tax to its stockholders, why can't we force a Swiss corporation to comply with the U.S. minimum wage laws by making it a crime to own stock in a foreign corporation paying less than the U.S. minimum wages or by denying tax credit for the taxes paid.

In other words, aren't we opening a very interesting philosophical door here?

Secretary DILLON. I don't think so, because this door has been open for quite some time.

We have had a law on our books for, I don't know, nearly 20, over 20 years, where in the case of the foreign personal holding company we tax the American stockholder, and we do not tax the foreign company or the foreign subsidiary. That is the basic reason why this law does not run afoul of any of our tax treaties.

If we started trying to tax the foreign subsidiary directly itself, it would be a different matter. But we tax here only the American stockholders, and I think this is an exact parallel with the foreign personal holding company provisions act. I don't see how we could go into other fields except the taxation of profits.

Senator BENNETT. Wouldn't this kind of an approach encourage other countries to apply similar provisions to any investments they might have in the United States?

Secretary DILLON. It could, but the difference is that most of these foreign countries—all of them, in fact, that I know of at the moment, except Germany—exercise control over their foreign investments by means of exchange control. By these exchange controls they require

agreements from the company about to make an investment as to how they will repatriate their earnings, how much they will be allowed to put abroad, and so forth.

So, through exchange controls, they achieve an objective that goes even beyond what we are talking about here, so it wouldn't be necessary for them to do this sort of thing.

Senator BENNETT. But when they go that route their operation is more flexible than the situation would be if we automatically required the taxation of all earnings of foreign subsidiaries.

Secretary DILLON. It is more flexible and more severe at the same time, yes.

Senator BENNETT. Flexible means that it can be lighter or heavier.

Secretary DILLON. Right.

Senator BENNETT. That is right.

Wouldn't the effect of this proposal, which prevents American enterprises from minimizing their foreign taxes, be to impose an additional tax burden on American companies abroad higher than that which would be imposed on their foreign competitors and thus give them an additional handicap to carry in foreign competition?

Secretary DILLON. Yes.

Senator Long asked that, and certainly if we go the route of eliminating deferral, which is our recommendation, that would generally be the case, although the increase in the tax would not be very large.

Now, in many of the biggest countries such as England, France, and Germany, the rates are about identical with ours, but as I pointed out earlier, at least in England and France—I mean England and Germany, not France—there are a number of special exceptions which generally lower the effective rate a good bit below the published rate, maybe down somewhere in to the average area of 40 percent or 40-45 rather than the 50-52, so there would be that difference.

But we don't think that that would be a significant factor if there is an investment to be made there which is really profitable, and which will lead to good business and be a good investment for the United States.

On the other hand, when it comes to the tax haven aspect of this thing, as I also pointed out earlier, there we might very substantially increase the tax. But foreign countries don't use tax havens to anywhere near the extent that we do. In many of the cases where they do use them, they use them under these agreements that profits will be repatriated, which is pretty much the same thing which we are talking about here.

Senator BENNETT. Well, Mr. Secretary, I would like to leave this area because I am sure there are other members of the committee who have other questions on the foreign tax, and move over to the withholding provisions.

The Commissioner of Internal Revenue Service, Mr. Caplin, was quoted by Business Week as saying:

That the system combining automatic data processing and account numbering will—

and these are his words—

automatically put the finger on those who fail to file returns, who owe taxes for previous years, who filed duplicate claims for refunds, whose returns show discrepancies or unusual characteristics that warrant investigation.

In addition our distinguished chairman cited the Treasury statement that the account numbering legislation passed last year was the best loophole-closing bill that has ever been presented to the Congress.

The Treasury had previously testified that enactment of this measure would increase the tax revenue by \$5 billion.

In view of these statements, why do you feel it is necessary to ask for withholding at this time when automatic data processing in conjunction with account numbering is just about to be utilized?

Isn't it possible that much or all of the revenue gap could be closed without withholding? At least shouldn't the ADP account numbering system be given a test before the more cumbersome and expensive withholding system is put into effect?

Secretary DILLON. In the first place I don't think that the withholding system is more cumbersome and more expensive.

The expense would be about even, because to work under the ADP system we would, of course, have to reduce the requirements for reporting on interest accumulations from the present \$600 down to, say, the same as those for dividends, which is \$10, and maybe even lower, and that would involve, at the \$10 figure, some 250 million information returns.

With those returns fed into the ADP system, when the ADP system is functioning, which will be 4 or 5 years from now, of course, it will be possible to identify areas of discrepancy which would include non-reporting of dividends and interest.

However, this noncompliance in this area is so massive that the figures are rather staggering.

The Internal Revenue Service estimates that this would turn up some 6 million returns which don't show any interest and dividends but which should have, and probably as many more, maybe a little more, that have only declared part of their interest and dividends.

In addition, it would turn up a substantial number of returns indicating that they are not paying what they should, where actually the taxpayer has done everything he should.

This is the case of interest on coupon bonds that have been bought or sold during interest periods, because the ADP would only know that company X paid so much interest to so and so and he only declared half of that for the period he owned the bonds, so that this case would be added to cases of underreporting. You would have a total of some 15 million—approaching 15 million discrepancies that you would have to check each year.

The Internal Revenue Service has estimated that if they were asked to do that job, it would result in so much extra work that they would have to have at least a 70-percent increase in their total enforcement personnel which they now use for all revenue collection in the United States of all kinds. That is the reason why the Commissioner of Internal Revenue feels that it would be completely impractical to try to do this by ADP and enforcement. The inconvenience to the American public of having these thousands and thousands of new agents calling on people all the time, verifying figures, would be far worse than the simple act of withholding.

Senator BENNERT. It is my understanding that the present information return system on dividend income turns up 92 percent of the dividend income.

Secretary DILLON. Taxes on dividend income are generally rather well paid. There isn't as much avoidance or nonpayment in dividends as there is in interest, where the gap is about a third, a little over a third.

Senator BENNETT. Don't you think that similar information returns program might reduce the present difference and bring interest returns up to somewhere near the 22 percent?

Secretary DILLON. No.

We think that the difference there is really the different type of ownership. Different people receive dividends. The latest indication we have from figures that are available now is that the dividend gap, in spite of information returns, has been increasing percentage-wise in the last couple of years. I think that is because a greater number of people are receiving dividends. The increase in numbers is beginning to approach, going in the direction of, those in the interest field.

Senator BENNETT. The estimated \$680 million additional revenue anticipated from withholding, a substantial portion, or about \$180 million, represents your staff's estimate of "assumed improvement in reporting in the higher income brackets."

Isn't there every reason to believe there could be an even greater degree of compliance in the upper income brackets under a combination of full information returns and automatic data processing?

Aren't most of these people already checked by the agents?

Secretary DILLON. They are mostly checked, and the figures that we used are what could be reasonably collected by automatic data processing. This is this \$200 million figure, which does allow for the probability that more people will report as a result of ADP.

But the compunction under automatic data processing is not nearly as great as the compunction under withholding, where you have to report the withholding at the end of the year on your tax statement and, therefore, if you want to get the credit for withholding in your tax statement you have to report the interest you paid to receive it.

Senator BENNETT. What use is currently made of the information returns now used on interest payments of \$600 or more?

Are these followed up?

Secretary DILLON. I would have to get you a report from the Revenue Service on that. I know that returns on dividends which go down to \$10 are not followed up in as much detail, because there are just not enough revenue agents to do this.

They use the information returns for the bigger returns that they have to audit, but they haven't enough personnel to follow them up generally at the present time.

(The material referred to follows:)

#### USE OF INFORMATION RETURNS—FORM 1000

A substantial sample of information returns is withdrawn annually. The sample is based on beginning letters of the payee's surname and is varied each year. These information returns are alphabetized, associated with returns selected for audit and checked against index cards to detect delinquent filers. A sample of the balance is associated with the related income tax returns to determine differences between amounts shown on information returns and those reported on tax returns.

Senator SMATHERS. Mr. Chairman, would the Senator yield right on that point?



Senator BENNETT. Yes.

Senator SMATHERS. Is it your contention that on these very small interest and dividends machines, this automated action that had been suggested, they could not pick up the discrepancies?

Secretary DILLON. Oh, no.

As I said, it would pick them up, but there would be so many discrepancies, running up to 12 to 15 million in a year, that it would be virtually impossible to follow them all up. The machine doesn't collect anything. It just hands the discrepancies over to agents. Agents would then have to go out and visit these 12 or 15 million people. As I pointed out, this would result in an increase of at least 70 percent in enforcement personnel in the Internal Revenue Service just to do this one job. I think that would be a lot more unpleasant to the American people than the very simple withholding procedure which has been suggested and which, when it is in effect, I think will very rapidly become accepted.

Senator SMATHERS. On that point, do you think that if the discrepancy were revealed by the action of the machine and then some publication was made in the local press, we will say, as to those who had not paid, do you think that might have some effect or not? [Laughter.]

Secretary DILLON. Well, we have been through that many years ago. There was a time when tax information was published and then Congress decided that that was not the way to operate, so we do not now do that.

One question might be, could these discrepancies be collected just by sending a bill to a person? The record of the Service indicates that this would not be very fruitful, because even in cases where there are agreements with taxpayers that they owe some tax, they haven't paid. The amount and everything is agreed, but when they send out mail requests for payment, the returns have averaged something around or a little less than 40 percent only, and 60 percent they can only get by having a collecting agent go out and get ahold of the fellow and get the check right from him.

In this case, where there is no agreement, and where there might be special reasons, something not put down in the tax return, certainly that figure would be far less. So only a very small proportion would be subject to payment by automatic mailing. The rest, in the tens of millions, would be subject to agents going to see them, which would be something we haven't seen in the United States in the Revenue Service and I don't know that we want to see it.

Senator BENNETT. In considering the cost—

The CHAIRMAN. Would the Senator yield?

Senator BENNETT. Yes.

The CHAIRMAN. The Senator from Utah has referred to the statement made by the chairman of this committee when the so-called numbering bill was passed.

As I recall it, the bill was under consideration about midnight on the last night of the session in September. The chairman then stated upon authorization by the Treasury, that this was the greatest loop-hole-closing bill that had ever been enacted, and that it would bring in \$5 billion of additional revenue to the Government.

Does the Treasury still think that is a correct statement?

Secretary DILLON. I think it is a tremendous loophole-closing bill, and that it will give us the leads that we can use to go after people who have avoided tax in a way we have never been able to do before.

It also will provide many services to taxpayers that will greatly speedup and make more accurate refunds and things of that nature, it is very helpful.

I don't know where that particular estimate of what it will bring in came from, whether that is—

The CHAIRMAN. That was the estimate given to the chairman by either the Treasury or the Internal Revenue.

Secretary DILLON. By them. Well, if they gave it, then I think under those circumstances it probably is an accurate estimate.

The CHAIRMAN. I think it was given before this committee. Didn't the Secretary appear before the committee in support of that bill?

Secretary DILLON. I don't recall that there was public testimony on that before this committee.

The CHAIRMAN. You don't think, then, it is effective in the collection of dividends without withholding?

Secretary DILLON. It doesn't collect anything. It only identifies discrepancies, and in a case where you have massive noncompliance, which is the case here, this is the only—

The CHAIRMAN. The Chair understands it does not collect anything but it gives the information to the Internal Revenue—

Secretary DILLON. That is right.

The CHAIRMAN. As to where the collections can be made.

Secretary DILLON. That is correct.

Provided you wanted to increase your Revenue force by 70 percent for this one purpose, and to add literally thousands of agents who will be calling on millions of people to do this, it might be possible. But certainly there has been great philosophical reluctance in appropriation committees to increasing the Revenue Service by any such dramatic amount, because they feel that this is something that is so contrary to our self-discipline system of paying taxes. You would really have to change that system quite considerably if you wanted to collect these taxes by agents and ADP.

The CHAIRMAN. The machine does a good deal of the work, doesn't it? That is what I understood.

Secretary DILLON. The machine gets the figures and then you have to go out and find the person and get the check out of him and be sure—

The CHAIRMAN. If these are reported to you, and these dividends are now reported to you, are they not, by every corporation?

Secretary DILLON. Dividends are.

The CHAIRMAN. And the laws can be changed to compel the interest to be reported.

Secretary DILLON. That is correct, changed by regulation.

The CHAIRMAN. Therefore, you will have the information and, as I understood it, the machines then would apply that information to each number.

Secretary DILLON. That is right.

The CHAIRMAN. And thereby find out what a taxpayer should pay and certainly you would have enough law to require them to pay it.

Secretary DILLON. We would get the information, but it would show that there would be some 12 to 15 million delinquent accounts and we never have had any experience with trying to collect out of any such number of delinquent accounts, and it would require this very dramatic, as I said, this 70 percent increase in enforcement personnel of the Internal Revenue Service just to carry out this one aspect, which wouldn't seem to be a proper thing to do.

The CHAIRMAN. How many numbers have been assigned now?

Secretary DILLON. I think—I will have to give you a report on that, Senator. I think that individuals were supposed to get their numbers this year during either, already or during the course of this year, so they would all be assigned by the end of the year.

Then they begin using them as the ADP systems goes into effect.

It is not in effect at present for individual taxpayers anywhere. But it will go into effect next year for individuals in the Southeast, and thereafter will build up quite rapidly and I think by 1966 it will be in effect all over the country.

The CHAIRMAN. You have already assigned the social security numbers, haven't you?

Secretary DILLON. That is right.

The CHAIRMAN. And that is a good part of the taxpaying public.

Secretary DILLON. That is a good part, yes.

People who are required to get other numbers are supposed to do it this year.

The CHAIRMAN. Are you pushing it all you can to give all the numbers?

Secretary DILLON. Oh, yes, pushing it all we can.

The CHAIRMAN. How many people in the social security system pay taxes?

Secretary DILLON. I would have to look up that figure. I don't know. We have an item in our budget, Senator, this year, I think for some \$5 or \$6 million to reimburse the social security system for providing numbers for those people who don't have them, which is the way they will get them.

(The information referred to follows:)

DATA ON ASSIGNMENT OF TAXPAYER ACCOUNT NUMBERS (BASED ON 1959  
STATISTICS OF INCOME DATA)

Of the 60.8 million tax returns filed for 1959, 54.8 million had social security coverage and therefore have account numbers. About 5.5 million had no social security coverage, of which 3 million were taxable and 2.5 million were nontaxable. In addition, there were 2.5 million nonfilers who were not covered by social security.

Therefore there will be approximately 8 million applications for account numbers from persons who do not at present have social security numbers.

Approximately 200,000 new account numbers for income tax purposes had been issued as of the end of April 1962.

The CHAIRMAN. Do you regard the withholding system as, that you recommend it as a tax collection system rather than an information system whereby you can get the information, and require the taxpayer to pay it?

Secretary DILLON. Withholding is an automatic and relatively simple tax collection system, so we get the money in with little expense, without a great number of agents going around and harassing people,

it has proved acceptable for wages and salaries, after people got used to it, and we are sure the same thing will apply here.

We have got withholding exemptions so it does not affect anybody who does not owe tax. For those people such as elderly couples, where there might be a small tax and might be overwithholding there would be our quarterly refund procedure, so that the impact would really be very minor. There has been a great deal of misinformation that overwithholding would really hurt that class or type of person. It wouldn't hurt them at all.

The CHAIRMAN. You think it is more of a tax collection plan than one for collecting taxes that could not otherwise be collected, under the numbering system?

Secretary DILLON. You can collect them easily by withholding. The only other way to do it would be, as I say, to have this large increase in Internal Revenue agents, and have a very different-----

The CHAIRMAN. My opinion of this withholding tax is that it is only justified when you cannot collect the tax in any other way. I don't think we should impose that great burden upon the business people and others to do the work of withholding and all of this refund which is very complicated, as you well know.

And I would like to ask you again, is this withholding devised as a collection proposition or is it for the purpose of collecting taxes from those who are now evading taxes and which can be collected under the number system?

Secretary DILLON. This is primarily a collection method, and certainly, as we look at it, it would not be terribly complex for the great majority of payers of interest, not much more than furnishing the information returns which they would have to furnish if you tried to do it the other way, and the other way is just literally impractical when you have to collect deficiencies from 12 to 15 million people.

We just never have had an enforcement problem of that nature in this country, which we have tried to handle by having enough agents to go around to knock on every door, and I don't think that that would be something that our people would like at all. It isn't necessary to have that great buildup in the Revenue Service if we adopt this withholding system.

The CHAIRMAN. Do you agree that when the numbering system is in operation that it will furnish you with necessary information whereby you can collect the taxes which you now think are being evaded?

Secretary DILLON. Provided we employ a vast number of agents to go out and make the collections; it will give us the information.

The CHAIRMAN. Have you estimated the expense it will put on the businessman? You say the Government hasn't got enough agents. Practically every business organization will have to employ more people on withholding; they will have to keep the records.

Secretary DILLON. The only testimony-----

The CHAIRMAN. I think on the refunds you have greatly underestimated the complexity of these refunds and the difficulty of making them and of checking them.

Secretary DILLON. The refunds will be made, of course, by the Government, and we think they will be simple. We have handled refunds

on wages and salaries in much greater volume. We have handled refunds for gasoline taxes—they go back to farmers—with no problem at all, and the Internal Revenue Service thinks they can do this.

So far as the costs for banks, for instance, are concerned, the only testimony I have seen estimating the cost was from one bank in Long Island, a very large bank with three-quarters of a billion deposits, and they estimated that the net result of withholding once it was in effect would be that their earnings of \$10,025,000 would be reduced by \$11,000 and that doesn't seem to be a very large amount.

The CHAIRMAN. Just to emphasize it again: You agree when the number bill is operating that information will be sufficient whereby the Government, if it has the agents to do it, can make the collection?

Secretary DILLON. If the Government hires a vast number of agents and information returns are obtained for all payments.

The CHAIRMAN. Therefore, you are asking for withholding as a plan to collect taxes that are being evaded.

It is to put the burden on the businessmen of this country to collect the taxes and remit them to you, and in addition there will be the hardship on citizens which will result from withholding more than individual taxpayers may owe.

Secretary DILLON. We don't agree there would be any noticeable hardship, and I think we can show that by figures very clearly.

But certainly taxes can be collected if every American turns into an agent; certainly we can collect taxes because we will have the information.

The Revenue Service would become very unpopular. The Revenue Service would be approaching sort of a police type of operation if we have that many people calling on everybody and we think that is just impractical. It would be much more objectionable than the very minor inconveniences of withholding.

The CHAIRMAN. I want it made crystal clear that—if it is possible to do it, if you have the number system—you can get the information on each taxpayer and that information will be available to the Internal Revenue Department and then it is simply a question of collecting the taxes; is that right?

Secretary DILLON. That is correct.

The CHAIRMAN. All right.

Senator KERR. At that point may I ask a question?

Senator BENNETT. Yes; I am happy to yield.

Senator KERR. Will the number system, when implemented, provide the information with reference to the income of those who do not file returns the same as those who do?

Secretary DILLON. Well, it will provide information on anyone who has a tax number who has ever filed a return at any time in his life.

Senator KERR. But it would not provide information with reference to anybody who did not have a number.

Secretary DILLON. No. Every taxpayer who files a return is supposed to have a number, but someone who had never filed a return might or might not have a number. You would get information if he had a social security number.

Senator KERR. I understand.

Secretary DILLON. He would be supposed to give that number to his savings bank and they would be supposed to send in the information.

So I guess you would have the information, even if you didn't have any tax return to put it up against.

Senator KERR. But there has to be a number of people—I don't have any way, I don't know whether you do or not, of determining how many—who never filed a return, and who do not have a social security number, with reference to whom not even the machines would produce the information.

Secretary DILLON. I think that is probably correct.

Senator KERR. Now, then, with reference to the additional agents, what has been the experience of the Department in getting appropriations from the Congress to employ the additional agents that the Department has asked for?

Secretary DILLON. Well, it has been very difficult. We have never been given the amount of agents that the Internal Revenue Service feels is necessary. A program for improving the Internal Revenue Service was set up 2 or 3 years ago under Commissioner Latham and Secretary Anderson, and is a phased, long-term program and we have been trying to follow it.

We have made some modifications where we thought not so many agents were needed but we never got more than about half or 60 percent of the agents that we have requested, and the numbers we have been requesting are much smaller, of course, than anything I am talking about in connection with this ADP.

Senator KERR. And the requests you have been making have been to have a staff adequate for a very limited operation insofar as the checking of all of the income tax returns is concerned?

Secretary DILLON. It is for better checking of important income tax returns, such as large corporation returns.

Senator KERR. In fact, the staff increases you have requested have been primarily with reference to the larger taxpayers, has it not?

Secretary DILLON. Primarily, and also to be able to carry out with smaller taxpayers a very small amount of spot checking where you just automatically pull out and examine at random 3 or 4 percent of the returns.

Senator KERR. Three or four percent?

Secretary DILLON. Yes.

Senator KERR. But the requests have never been made for a staff that would do more than that?

Secretary DILLON. No.

Senator KERR. And the requests that have been made have resulted in your receiving 40 to 50 percent of the amount you have requested?

Secretary DILLON. Right. About 50 percent.

The CHAIRMAN. Mr. Secretary, would you furnish the committee with the requests that have been made and then what Congress gave for the past, say, 3 or 4 years?

Secretary DILLON. Yes; I would be delighted to.

Senator WILLIAMS. Would you also, Mr. Secretary, furnish the committee with a copy of the recommendations for increased staff that accompanied your request for approval of the numbering system?

I remember the Department's claim that by approving the numbering system it may bring in an additional \$5 billion, but I fail to recall the suggestion that that estimate was contingent upon an increase in the staff of 70 percent, but perhaps—

Secretary DILLON. Ah, no; I didn't say that was contingent on an increase of 70 percent of the staff. It was only 70 percent if we are going to try to use the numbering system to solve this particular underreporting problem, this evasion of taxes on interest which amounts to some hundred million dollars, not 5 billion at all.

Senator WILLIAMS. I see. Will you furnish us with a copy of your suggestion for an increased staff that would be necessary with the approval of the numbering system?

Secretary DILLON. Yes.

(The information referred to follows:)

*Comparison of increases requested and achieved in number of Internal Revenue Service employees, fiscal years 1960-63*

(Average positions)

Category	1960 Increases		1961 Increases		1962 Increases		1963 Increases		
	Re- quested	Actual	Re- quested	Actual	Re- quested	Actual	Re- quested	House allow- ance <sup>1</sup>	Senate allow- ance <sup>2</sup>
Revenue agents.....	123	(-67)	666	421	1,385	1,127	1,278	168	607
Revenue officers.....	155	(-13)	344	325	376	129	294	54	214
Office auditors.....	197	(-82)	331	359	704	752	241	50	191
Special agents.....	(-4)	(-28)	61	66	101	164	94	31	80
All other permanent.....	18	(-702)	987	1,116	1,438	1,581	2,257	1,195	1,684
Total permanent.....	489	(-895)	2,298	2,257	4,912	3,552	4,159	1,494	3,376
Temporary.....	237	1,050	508	(-50)	633	819	355	203	366
Grand total.....	726	(-215)	2,806	2,167	4,576	4,071	4,514	1,697	3,731

<sup>1</sup> Based on 1962 financial plan.

<sup>2</sup> Estimated.

<sup>3</sup> Includes changes resulting from conversion of permanent positions to temporary.

NOTE.—The actual increases do not reflect congressional action exclusively, but also include the results of administrative adjustments, such as losses in positions in 1960 due to an unexpected decrease in attrition rates which resulted in higher average salary costs.

The enabling legislation amending the Internal Revenue Code to authorize the Revenue Service to require taxpayers to use numbers on their tax returns was considered by the House Ways and Means Committee and the Senate Finance Committee. Since these committees do not handle appropriations, it was inappropriate for the Department to seek funds or personnel in connection with this legislation in its appearances before them. However, the Treasury Department's original appropriation request for the fiscal year 1963 included \$10 million to reimburse the Social Security Administration for the issuance of additional numbers which will be used on tax returns. The request also included 4,514 additional positions to bolster Revenue Service's staff. Although none of these positions was specifically earmarked for the enforcement of unreported dividends and interest, some portion would certainly be utilized for these purposes as a part of the normal enforcement.

The CHAIRMAN. As you get the increased staff, the number that you want and have the numbering system, then you can collect the taxes that are due, providing that you can get information as to—you have already got it for dividends, interest and as I understand it that is only above \$600, is it?

Secretary DILLON. That is all we ask for now.

The CHAIRMAN. You think the combination of the two would enable you to eliminate this tax evasion loss if you got the number system and an adequate staff to police it?

Secretary DILLON. I think the staff to do the withholding would have to be unreasonably large. We would have to have the increase

that we have already asked for and then on top of that this very substantial expansion.

The CHAIRMAN. I am not aware of the fact—did you say 70 percent—you were allowed what percentage of the requests you made?

Secretary DILLON. I said on the average we have gotten about half of the agents we requested.

The CHAIRMAN. You have gotten half?

Secretary DILLON. Yes.

The CHAIRMAN. I am recognized, I think, as a man who has voted for economy, but I have always voted for the auditors and the staff of the Internal Revenue, because I think a dollar spent there brings a number of dollars back in the Treasury. And I believe that—if you would make a clear statement and get the facts clearly before the Congress, especially if we could avoid this withholding tax thereby—you would get a good deal of support for staff adequate to collect the taxes.

Secretary DILLON. I must say the Senate has always been very strong in support of our requests for needed agents. It is the other body which has felt differently about it, and has continually allowed us a very small number. We generally wound up with a compromise after conference.

Senator BENNETT. Mr. Chairman, you have been very patient with me today, and I would like to just clear up one or two other questions on this withholding provision and then I would be happy to step aside for someone else, although I admit I still have some other questions in other areas.

We have not discussed the impact of the cost of keeping exemption certificates up to date and the difficulty for the company or person who pays interest and dividends of making sure that this exemption filed is accurate and dependable.

Did you include this cost when you were talking about a savings bank which was going to operate this bill for \$11,000 a year?

Secretary DILLON. I didn't—those figures were the figures given by the bank, their estimate of what they thought their costs would be under the bill. So I don't know what they included.

I did recommend in my earlier statement today that a provision should be made for exemption certificates to be permanent until revoked. This was one of the things requested particularly by the banks and various payers of interest. They thought that would greatly ease their problem. We think that would greatly help with the problem that you mentioned.

Senator BENNETT. My next question will probably reveal my ignorance of some of the details of the bill.

If a taxpayer who will actually owe no taxes has his or her income from dividends and interest divided among five or six sources, will the Treasury records make it possible for that taxpayer to make one request for a refund or will five or six requests have to be made?

Secretary DILLON. One request.

Senator CURTIS. Would you yield right there?

Senator BENNETT. Yes.

Senator CURTIS. What sort of proof will that person have to submit?



As I understand it, the person who withholds the tax and remits it does not send the form to the individual who has the interest coming; is that correct?

Secretary DILLON. Not necessarily, no.

Senator CURRIE. What proof will the applicant for refund have to submit?

Secretary DILLON. He will just have to submit an affidavit signed by himself that this refund is owing to him.

Senator CURRIE. And the location and identity of the people who withhold it?

Secretary DILLON. It is just a very simple refund form, and you will then receive your refund. This would be checked at the end of the year just as tax returns are normally checked.

Senator BENNETT. Wouldn't that be a considerable burden on the Treasury? I will ask another question first: As I understand your last answer it will not be necessary for the applicant for refund to indicate the issues or the stock, the source of the stock, or the location of the payer when applying for a refund. If you don't get that information how can you go back to check whether the refund was in fact legitimate?

Secretary DILLON. The claimant will identify each In that  
case, I think there is just a question of fraud. We don't assume that people who will do this will all be trying to defraud the Government, and we think that there will be only a very minor incidence of fraud.

We pay out on refund claims now. We are very experienced in handling this, and people can at present, when they claim a refund, make fraudulent claims on wages and salaries. But we found that has not required a great deal of extra help.

We pay now for refunds on wages and salaries some 37 million checks a year, and the maximum that we can possibly conceive will be necessary under interest and dividend withholding would be 2 million or less, so it is a very small thing compared to what we are already doing.

We also pay out another million checks for gasoline refunds, and this would only be twice as much as that. So it would not be a very big extra burden for the Treasury. We do have experience in handling this thing.

Senator BENNETT. Of course, there is this difference, and maybe I am building a mountain out of a molehill but when you refund money withheld from a salary you are dealing with one employee whose salary was withheld by one employer.

But when you are dealing with refunds of money withheld on interest and dividends you may be dealing with half a dozen sources.

Secretary DILLON. The taxpayer would list his interest and his dividends and his payors but I don't think he would have to go into any detail on it.

Senator BENNETT. So you are just going to go it blind.

Secretary DILLON. We are going to accept what the taxpayer certifies is true, the same way as we accept his tax return when it comes in.

Senator KERR. Under oath.

Secretary DILLON. Under the same sort—

Senator KERR. Affidavit.

Secretary DILLON. Affidavit. The same sort of thing as the tax return. I don't think that is under oath, but you have certain penalties for filing false returns.

Senator BENNETT. But the taxpayer is going to have some problems if he gets no notification as to the amount withheld, the problems of determining whether this diminution of his income is in fact the result of the amount withheld or it may be the result of the change in rate.

Secretary DILLON. No. The taxpayer will know that any income which he gets for interest or dividends has already had 20 percent withheld on it, and on these forms it would be very simple. All he has to do is add back one quarter of what he gets and then he would have the amount that he has withheld. A quarter of 80 is 20.

Senator BENNETT. This would be theoretically true if you withhold on interest payments of any size from 1 cent up.

Secretary DILLON. That's right.

Senator BENNETT. And you expect to do that?

Secretary DILLON. That is right.

Senator BENNETT. Well, you talked earlier about 250 million returns, and this referred only to transactions of \$10 or more, did it not?

Secretary DILLON. That was information returns. I said it would be even more if we asked for information returns lower down. If we asked for information returns covering everything it would be something like 750 million. It is just an incredible amount of work.

Senator BENNETT. What about the question of the handling of withholding on marketable bonds.

As I understand it even though people may be exempted for being under 18 or being over 65, this exemption will not apply to marketable bonds?

Secretary DILLON. That is correct.

Senator BENNETT. Don't you think this is an area that will confuse the ordinary person, and breaks down your statement that all they have to do is add 20 percent to all their income.

Secretary DILLON. No, because they will still be withheld 20 percent on the marketable bonds. The only thing they won't be able to do is file an exemption certificate.

Senator BENNETT. I see. So that they can't get the exemption in this case, even though, in fact, they might be entitled to it?

Secretary DILLON. That is correct. And we think there are very few people in that position, because very few people who own coupon bonds would be entitled to exemption; because they usually have other forms of saving.

Senator BENNETT. Don't you think this might tend to drive these few people out of this particular type of investments?

Secretary DILLON. It might, to the extent that it is concerned. But the banks who are the paying agents for this type of bonds have just said the exemption certificates in this type of area would be impossible and we agree with that.

Senator BENNETT. A table in the 1962 Treasury Bulletin estimates that about 10 percent of the public obligations are owned by individuals.

Secretary DILLON. That is right. But they own fairly large ones. I think those are people who will continue to own such bonds if they pay tax.

Senator BENNETT. Do you have any estimate of the amount of under-reporting that there may be in this particular field?

Secretary DILLON. Our estimate is that we lose on coupon bonds some \$50 million in tax from underreporting.

Senator BENNETT. Mr. Chairman, I would now be very happy to step aside and take my turn another time around, because I do have some other questions.

The committee has been very patient with me and I have tried to express my gratitude by yielding freely to everyone who has asked me to yield.

The CHAIRMAN. The Chair recognizes the Senator from New Mexico, Senator Anderson.

Senator SMATHERS. Mr. Chairman, may I just ask this, Will we have an opportunity to question the Secretary at some other date, if we—

The CHAIRMAN. I understand the Secretary is leaving tonight to go to Hot Springs and then to Rome and that you would be back on May 21. Will it be in the morning?

Secretary DILLON. I would be back here in the afternoon of May 21.

The CHAIRMAN. We want to expedite this all we can but, of course, until you get back, there is nothing much the committee can do except to go over the hearings that have already been held, and if you permit me to make a suggestion: when you come back on May 22, consolidate your two statements into one so that the committee will not be confused. As I understand it, you have modified some of your original recommendations.

Secretary DILLON. That would be helpful.

The CHAIRMAN. In what you said today.

Secretary DILLON. That can be done the next day or two.

The CHAIRMAN. You can get your staff to do that and put it in the record.

Secretary DILLON. That can be done.

(The summary statement follows:)

#### CHANGES IN H.R. 10650 RECOMMENDED BY THE TREASURY DEPARTMENT

This paper lists, section by section, the various recommendations for changes in H.R. 10650 which Secretary Dillon presented to the Senate Finance Committee on April 2 and May 10, 1962. Page references are to part 1 of the printed hearings and the typed statement of May 10, the latter references being marked with an asterisk (\*).

#### *Investment credit (sec. 2)*

1. The investment credit should be increased from the 7 percent to 8 percent as originally reported by the House Ways and Means Committee (p. 86).
2. The House limit on the credit of the first \$25,000 of tax liability plus 25 percent of the excess should be raised to the first \$25,000 of tax liability plus 50 percent of the excess. However, this higher limit should become applicable with respect to taxable years beginning on or after January 1, 1963 (p. 86).
3. Investment by regulated public utilities, including gas pipelines, should not be eligible for the credit (pp. 86 and 87).
4. The bill should be amended to provide for a 3-year carryback of unused investment credits. Such unused credits should not be carried back to taxable years before those for which the credit is effective (p. 2\*).
5. Livestock should be excluded from obtaining the benefits of the credit (p. 2\*).
6. Clarifying language should be added to the committee report to indicate whether specific items, such as refrigerator cases used in the grocery business

and testing equipment used in the aerospace industry, are eligible for the credit or would be disqualified as structural components of a building (p. 2\*).

*Lobbying expenses (sec. 3)*

1. The section, which would permit substantial deductions for lobbying expenditures, should be deleted from the bill (p. 95).

*Expense accounts (sec. 4)*

1. The less certain and only partial approach of the House bill should be rejected. Treasury recommends, instead, that the cost of business entertainment, including club dues, and the maintenance of entertainment facilities (such as yachts and hunting lodges) should be disallowed in full as a tax deduction (p. 89).

2. Restrictions should be imposed on travel expenses for vacations that are combined with business travel. The costs allocable to the vacation should not be deductible.

3. A special exclusion should be made from the \$25 business gift limit in the House bill to ease the accounting problems of suppliers of low-cost novelty advertising items (pp. 3 and 4\*).

4. A statement should be added to the committee report to indicate that advertising devices such as display racks and advertising signs provided for use in business are not covered by the gift disallowance provision (p. 4\*).

*Distributions in kind by foreign corporations (sec. 5)*

No changes

*Allocation of income between U.S. and controlled foreign entities (sec. 6)*

No changes

*Distributions of foreign personal holding company income (sec. 7)*

No changes

*Mutual savings banks and savings and loan associations (sec. 8)*

The special deduction of 60 percent of income should be reduced to 33½ percent (p. 94).

*Foreign trusts (sec. 9)*

No changes

*Mutual fire and casualty insurance companies (sec. 10)*

1. Eliminate the provisions for the protection against loss account and the protection against loss deduction (p. 93).

2. The transition to regular corporate taxation should be gradual—over a 5-year period (p. 93).

*"Grossing-up" distributions in computing foreign tax credit on dividends from foreign subsidiary corporations (sec. 11)*

Make provisions applicable to all distributions after December 31, 1961 (p. 98). Under House bill the provisions would not apply to pre-1963 earnings of foreign subsidiaries distributed as dividends before 1965 and would not apply to distributions of current earnings prior to January 1, 1963.

*Exemption of earned income of individuals living abroad (sec. 12)*

1. No exemption for citizens residing or physically present in developed countries (p. 96). House bill would have allowed a \$20,000 exclusion in either category and a \$35,000 exclusion for residents after third year.

2. Limit annual exemption for citizens in less developed countries to \$20,000 under either the residence rule or the physically present rule (p. 96). House bill would have allowed residents \$35,000 after third year.

*Controlled foreign corporation (sec. 13)*

1. Eliminate deferral for controlled foreign subsidiaries in developed countries, whether tax haven or operating, and no deduction for earnings reinvested in less developed countries (pp. 98-103 and p. 7\*).

2. If change No. 1 is not made, improve section 13 of H.R. 10650 by the following:

(a) Eliminate special coverage of U.S.-developed patents, etc., but amend section 1239 of code to provide that gain on the sale of patents, etc., by a

U.S. parent corporation to its foreign subsidiary be taxed as ordinary income (pp. 7 and 8\*).

(b) Change foreign base-company provisions:

(1) Add to base-company income income from related parties for rendering services outside the country for incorporation (p. 9\*).

(II) Provide exception for base-company income such as rentals, royalties, and interest where they constitute active income. Exception would not apply where received from related party for use outside country of incorporation of recipient (p. 9\*).

(III) Overall exception where corporation not availed of to avoid taxes (pp. 9 and 10\*).

3. Make clear that antidiversification rule does not apply to the earnings of a new business started with fresh capital from the United States. Also clarify when a trade or business will be considered to have been conducted by substantially the same interests (p. 10\*).

4. Eliminate reinvestment deduction for developed-country tax-haven profits. Allow reinvestment of dividends and interest received from active trades or businesses carried on within less developed countries on liberal terms (pp. 10 and 11\* and pp. 98 and 99).

5. Allow unrestricted use of earnings from less developed country corporations (pp. 11 and 12\*).

6. Make section 13 inapplicable to corporations incorporated under the laws of U.S. possessions (p. 12\*).

7. Modify definition of controlled foreign corporation:

(a) Count only U.S. shareholders owning at least 10-percent interest in determining whether U.S. control exists.

(b) Do not treat U.S. shareholders as indirect owners of stock owned by a corporation in which they have an interest unless at least a 10-percent interest (p. 13\*).

8. Provide greater recognition of losses of foreign subsidiaries (pp. 13 and 14\*).

9. Indicate that regulations will provide guidelines for computation of earnings and profits (p. 14\*).

10. Indicate that blocked income will not be taxed (p. 14\*).

11. Indicate that Treasury will be liberal in allowing reorganization of foreign corporate structures (p. 15\*).

*Gains from the disposition of depreciable property (sec. 14)*

1. Depreciation with respect to real estate hereafter acquired should be limited so as not to exceed depreciation under the straight line method (p. 88).

2. Gain on sale of real estate should be treated as ordinary income to extent of depreciation for taxable years beginning after December 31, 1961, where property is held for 6 years or less, the percentage of such gain subject to ordinary income treatment being reduced 1 percentage point for each month property is held beyond 6 years (p. 88).

3. Section 14 should be amended to provide for ordinary income treatment of gain on sale of depreciable property to extent of prior deductions for amortization of interests in depreciable property (p. 89).

4. Committee report should contain statement illustrating point that section 1245 does not require recognition of gain or loss at time of retirement of assets in a multiple-asset account as long as the taxpayer's method of accounting, in accordance with Treasury regulations, clearly reflects income (p. 3\*).

*Shares in foreign investment companies (sec. 15)*

1. Increase time permitted for reporting undistributed capital gains to shareholders (p. 17\*).

2. Provide pass-through of foreign tax credit to shareholders for taxes paid by the foreign investment company (p. 17\*).

3. Other technical amendments (p. 17\*).

*Gain from sale or liquidation of foreign corporations (sec. 16)*

1. Limit applicability of the new provision to earnings accumulated in the future. House bill applied to earnings accumulated since 1913 (p. 95 and p. 15\*).

2. Mitigate impact on individual shareholders:

(a) Limit tax by treating distribution as if received over the period of shareholder's holdings.

(b) Limit tax to 64 percent of grossed-up foreign earnings, the same result as if corporation had been domestic and liquidated (p. 16\*).

3. Make section 16 inapplicable to corporations incorporated under the laws of U.S. possessions (p. 12\*).

*Tax treatment of cooperatives and patrons (sec. 17)*

No changes.

*Estate tax exemption of foreign real estate (sec. 18)*

Change effective date of House amendment from July 1, 1964, to January 1, 1963 (p. 96).

*Dividend and interest withholding (sec. 19)*

1. Exemption certificate system should be extended to dividend income of governments and tax-exempt organizations (p. 4\*).

2. Exemption certificates filed by individuals should be permitted to remain in effect until revoked by the filer; under the House bill, new certificates would have to be filed each year (p. 5\*).

3. Individuals should not be permitted to file exemption certificates with respect to interest on dividend accumulations on unmaturing life insurance policies (p. 5\*).

4. Refund allowance for quarterly refunds should be liberalized to permit an individual to take into account his itemized deductions; under the House bill he is permitted to take into account only his standard deduction (p. 6\*).

5. Eliminate withholding on dividends paid in the stock of another corporation (p. 6\*).

6. Permit a corporation a quarterly refund for the fourth quarter of its taxable year if the refund is expected to exceed the corporation's tax liability on its final return; under the House bill, the refund for the fourth quarter can only be obtained upon the filing of the final return for the year (p. 6\*).

*Information with respect to certain foreign entities (sec. 20)*

1. Provide that U.S. officers and directors of foreign companies which have no substantial U.S. share ownership need not supply information.

2. Provide that domestic subsidiaries of foreign parent corporations will not be required to supply information about non-U.S. subsidiaries of such parent corporations (p. 10\*).

3. Make clear as to all of section 20 that only such information will be required as set forth in regulations in existence on the first day of a taxable year (p. 17\*).

*Treaties (sec. 21)*

Eliminate section 21 providing that bill shall override treaties (p. 104).

*Eliminating artificial tax incentives to capital movements arising out of foreign tax credit computation*

Add a section amending the foreign tax credit provisions to provide that the foreign tax credit for certain investment income be computed apart from the foreign tax credit for all other income (pp. 103 and 104).

Secretary DILLON. I understand there is some work that your staff ordinarily does in analyzing the testimony prior to executive sessions and that that work could be going on.

The CHAIRMAN. That is going forward now, but we are anxious to give every consideration to your recommendations and as you have made some recommendations which you have modified it would be clearer to the committee just to make one statement of your present position.

Secretary DILLON. We will be glad to incorporate those into our original statement.

The CHAIRMAN. If it is agreeable to you and convenient to you we will set your next hearing for May 22 and there will be no session this afternoon.

Senator Douglas?

Senator DOUGLAS. I would like to emphasize, if I may, the importance of time in this matter.

The Secretary is going abroad for 11 days. If it is our intention to have him come back and answer further questions, then this means that the committee will not start considering the text of the bill for some days after that.

We know we have behind this bill the trade expansion bill and there are many of us who hope there will also be the health care for the aged bill. This committee and the House Ways and Means Committee are the funnels through which the most important legislation at this session will have to flow.

The CHAIRMAN. I would like to say to the Senator from Illinois we already have bills on our calendar, we have the welfare bills, and a number of other bills, that will occupy us next week.

Now, the Secretary advised the chairman he wanted to be here so he could answer questions when the bill was taken up in executive session and he was compelled as I understand it to go to Rome on a very important mission.

Secretary DILLON. What the chairman says is correct. I was informed and was under the impression that because of the work the committee staff has to do to analyze the testimony they have received, that they would not be ready in any event to undertake executive sessions until about the week of the 21st or 22d. That was the reason why I felt it was all right to take this trip to this important monetary conference. But if the committee is ready to start executive sessions sooner and wants to do that, I certainly feel this is most important. I would be glad to change my plans and not go, because I don't want my trip to delay the executive sessions of the committee.

But I understood that was not the case.

The staff of the committee needed this period of time anyway.

Senator DOUGLAS. Mr. Chairman, may I ask the witness a question?

The CHAIRMAN. Yes.

Senator DOUGLAS. Do I understand then that you believe this bill is sufficiently important that you would be prepared to forgo your trip to Rome in order to be present for any such further examinations the committee might wish to have?

Secretary DILLON. That is right. Anything that would expedite the bill.

Senator DOUGLAS. In other words, you regard the expedition of this bill as more important than your presence abroad?

Secretary DILLON. I think it is the most important thing I personally can do, although I think the meeting is very important.

Senator DOUGLAS. Mr. Chairman, I would suggest, therefore, that we not adjourn this matter until after the 21st but that we proceed with the examination of the Secretary and he could send a deputy to Rome.

The CHAIRMAN. It is always customary for the staff to have a digest of the testimony.

This has been very extensive testimony, 200 witnesses. It hasn't been completed. And the Chair, at the urgent request of the administration, has scheduled on Monday the public welfare bills for hearings for 4 days, and the witnesses have been notified and there are quite a number of other bills before this committee that will keep us occupied for the next week without any question.

Senator DOUGLAS. Mr. Chairman, I have great respect for the Chairman and I complimented him at the way in which he has had the record printed instead of deferring the printing until the conclusion of the hearings.

The Chairman has spoken about the necessity for a digest of testimony. In the words of a former Senator, I hold here in my hand a document entitled "Digest of Testimony Presented. Statement Submitted to the Committee on Finance With Respect to H.R. 10650, Revenue Act of 1902, Prepared for the Use of the Committee on Finance by the Staff of the Joint Committee on Internal Revenue Taxation."

I want to compliment the staff on keeping up to date in its work in this fashion. I think they deserve the highest commendation for their work, and I would suggest that this indicates that we are ready to go ahead. There is a saying in the law, justice delayed is justice denied.

Hearings delayed and consideration delayed is consideration denied.

So, I hope, Mr. Chairman, with all due respect to the distinguished Senator from Virginia, I hope very much that we may take advantage of this extraordinary offer of the Secretary in forgoing his trip to Rome in such a pleasant season of the year. He is willing to stay here and we can conclude tomorrow.

The CHAIRMAN. I would like to say the Secretary's trip to Rome is not taken at the suggestion of the Senator from Virginia. [Laughter.]

He advised the Senator from Virginia that he was anxious to go there if it didn't conflict with this bill, and he would be back May 21.

I have already scheduled these public welfare bills. The witnesses have been notified, and Secretary Ribicoff has been constantly pressing upon the committee to have the hearings and take them up.

That is the situation.

Senator GORE. Will the Senator yield for a question, Mr. Chairman?

I wonder if it would be an acceptable compromise to suggest that, instead of interfering with the hearings which have already been scheduled for next week, the Secretary be only 1 day late at the Rome meeting, and that the committee proceed to conclude with questioning him tomorrow.

Would you be willing to arrive in Rome 1 day later?

Secretary DILLON. Most certainly, but that would not make me 1 day late. I was going to attend a meeting of the Business Council tomorrow in Hot Springs and I will have the Under Secretary do that. He can do it perfectly well.

Senator GORE. I offer that suggestion for your consideration, Mr. Chairman.

The CHAIRMAN. I have no objection. The Chairman is perfectly agreeable to that. Of course, there is no assurance that the Secretary can complete his testimony in 1 day. He has brought in some new issues here, very substantial changes in the original statement he made.

I want the Secretary to understand and the committee to understand I am not trying to delay consideration of this bill, but I think it is a bill of tremendous importance, and should be examined in every line of it through 240 pages, and there is hardly a line of the 240 pages that is not controversial.



I have never had an experience with a bill such as this. It is our duty to the country to see it is fully considered from every standpoint, and if it is convenient to the Secretary we can hear him tomorrow morning.

SECRETARY DILLON. I would be glad to be here.

The CHAIRMAN. Unfortunately, I have to be away this afternoon as do several other Senators and we will have to adjourn before 1 o'clock unless the committee desires to go ahead.

So, suppose we start off tomorrow morning, Mr. Secretary, after Senator Anderson has some questions.

Senator BENNETT. Mr. Chairman, before the Senator begins, may I ask a procedural question.

The Senator from Illinois held up a galley proof of some work by the staff. Does that represent an analysis of all the testimony up to date, Mr. Stam?

Senator DOUGLAS. It consists of 60 pages of analysis.

The CHAIRMAN. The bill is 240 pages. [Laughter.]

Senator WILLIAMS. Could the staff tell us just how far they are in this analysis?

Mr. STAM. This digest is merely a listing of the suggestions made by the witnesses. We need some additional time to analyze these suggestions before reporting back to the committee.

That would take a little more time. This digest just gives us the suggestions that were made so we can readily look at them and then go to the hearings and look at the analysis of the reasons back of these suggestions.

Senator DOUGLAS. Mr. Chairman, this opens up endless vistas of interminable delay [laughter] and I think we have got to get down to business and not stall on this thing. I really—

The CHAIRMAN. The Senator can't say we are stalling. We have had hearings here day after day. We started 10 o'clock in the morning, adjourned at 12:30, started at 2:30 in the afternoon.

Senator DOUGLAS. The Chairman has shown remarkable vitality, I see his cheeks are still ruddy and he has stood up under the added burden.

The CHAIRMAN. The Finance Committee has heard everybody who desired to be heard. I have been on the committee 29 years and that is the way we have proceeded and so long as my influence goes that is the way we will proceed so long as I am chairman. I have not tried to hold the bill up or stalled it. I am opposed to certain parts of the bill and I am in favor of others and I think other members of the committee are experiencing similar inclinations. Some favor parts of the bill and oppose other parts. Go ahead.

Senator WILLIAMS. Mr. Chairman, I would like to ask the Secretary, if he has reduced to writing his suggestions that he made to the committee this morning?

Secretary DILLON. Oh, yes; you have it here.

Senator WILLIAMS. I know the suggestions, but I mean the language, the amended language for the bill that would carry out those suggestions.

Secretary DILLON. No. I think we could give you such language if that is your wish. We would, under the procedure we ordinarily use, proceed to develop language in consultation with the technicians of

the joint committee staff so they would also be in agreement with the language to carry out the specific ideas. If the committee wanted it, and if the committee wishes us to work with the staff to develop such specific language, we would be glad to work with them; of course, we want to work with the staff.

The CHAIRMAN. I just want to make one further comment.

This bill took 1 year in the Ways and Means Committee of the House, and our committee has been considering it for how long, about 5 weeks, isn't it?

Mrs. SPRINGER. Yes, sir.

The CHAIRMAN. I think we have made pretty good progress. We have gotten a lot of information from all sources.

Senator GORE. I want to thank the Chairman for his generous response to my suggestion. If we have sessions both morning and afternoon tomorrow, it may very well be that the Secretary's testimony will be concluded and we would then have the 10-day period of time during his absence for the staff of the Treasury Department and the Joint Committee on Internal Revenue taxation to be working while the committee, in turn, proceeds on the other bill. I appreciate the Chairman's reaction.

The CHAIRMAN. I want to make this further comment that we scheduled hearings on this bill a week before we were able to start them because the bill was delayed in the House. It was not referred to the Senate Committee on Finance until April 2 and our public hearings began the same day. There wasn't even 1 day of delay.

Senator CURTIS. Mr. Chairman, I do not expect to go into this, but the Secretary's statement indicates a number of important changes in this bill. Now, it is true that if we decide to accept or reject the changes to the original bill, the committee staff could cooperate on the language. But I would like to see a Treasury draft of what they propose so that it can be printed as a study print of the bill, and the people affected could get to see it before these hearings are closed.

I wonder if the Treasury can submit such a study?

Secretary DILLON. Of course we can. But these are technical matters for the staffs. We would hope that the language which we produced, if the committee later decided to use it, would be language that was satisfactory to the congressional staff, too, rather than having to go through it twice. That is our thought. If you wish us to do it without talking with the staff—

Senator CURTIS. I do not care who you have to help you, but I would like to see a study print of this.

Secretary DILLON. We would be glad to do that.

(There was insufficient time before the printing of this record to complete the drafting of the bill incorporating the amendments advocated by the Treasury Department. It was understood that the Treasury draft would be submitted to the committee in time for use in executive session.)

Senator GORE. Mr. Chairman, I think the Senator from Nebraska has made a reasonable request. I would like to have one, too.

Senator CURTIS. A study print so that the taxpayers involved—after all, somebody is going to pay this bill we are talking about—can see what their comments are as to the new version of the Treasury's proposal. They may want to testify, I do not know.

The CHAIRMAN. May I apologize to the Senator from New Mexico, who is now recognized?

Senator ANDERSON. Mr. Chairman, I promise you that I will try to be brief. I do suggest that sometimes on these hearings you might follow the precedent of allowing each member, say, a half-hour or an hour or something of that nature, and then you can get down to the infinitesimal parasites who rarely have a chance to get into it at all. [Laughter.]

Mr. Secretary, the Governor of the Virgin Islands, Mr. Paiewonsky, has given me a paper as chairman of the Senate committee on interior and insular affairs, regarding the problem they have on section 13. (The memorandum referred to follows:)

MEMORANDUM CONCERNING SERIOUS ADVERSE IMPACT OF H.R. 10650 ON VIRGIN ISLANDS PROGRAM FOR INCREASED ECONOMIC DEVELOPMENT AND SELF-SUFFICIENCY

H.R. 10650, as passed by the House, contains certain provisions which were developed to deal with U.S. taxpayers organizing foreign corporations abroad. But unless amended they would apply to Virgin Islands corporations, which are treated as foreign corporations for purposes of the Internal Revenue Code. Unless amended they would thwart the Virgin Islands program for increased economic development and self-sufficiency. And such provisions are not needed either (a) to avoid tax havens and tax avoidance—in view of the congressional legislation governing the Virgin Islands; or (b) to meet foreign exchange problem—since the Virgin Islands are, of course, part of the U.S. currency area. The Virgin Islands are subject to the wage-hour law, the National Labor Relations Act, the Sherman Act, and other Federal statutes regulating labor and business. It is requested that the committee adopt the recommendation of excluding the Virgin Islands Corporation from the term "foreign corporation" for purposes of sections 13 and 16.

1. Existing congressional statutes provide a pattern whereby (a) Virgin Islands is not available as a situs for tax havens, and (b) a tax subsidy is available only in limited circumstances, defined by Congress, to encourage U.S. citizens and corporations to develop the economic resources of the Virgin Islands: Individuals and corporations earnings or receiving income in the Virgin Islands incur a tax liability to the Virgin Islands equal to the tax imposed on U.S. income by the Internal Revenue Code. This is established by the Naval Appropriations Act of July 12, 1921 (48 U.S.C. 1397) and by section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642).

Thus the Internal Revenue Code applies in the Virgin Islands as a practical matter even though technically Virgin Islands income is foreign income, and Virgin Islands corporations are foreign corporations, etc.

Congress—acting as a superterritorial legislature—has enacted a statute adopting the Internal Revenue Code as the Virgin Islands tax statute.

Congress has further provided—by section 984 of the Internal Revenue Code, added by Public Law 86-779 that this tax "shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands" with these two exceptions:

The first exception is for U.S. or Virgin Islands corporations whose gross income for the past 3 years (a) was 80 percent derived from sources within the Virgin Islands, and (b) was 50 percent derived from the active conduct of a trade or business within the Virgin Islands.

The second exception is for U.S. individuals who are U.S. citizens resident in the Virgin Islands, to the extent of income derived from sources within the Virgin Islands (excluding compensation as employees of the United States and income from the sale of securities).

As to the purpose of these exceptions, see 86th Congress, Senate Report 1767 of June 29, 1960:

"This appeared to your committee to be in accord with the purposes of the special tax treatment long accorded possessions of the United States; namely, to encourage the development of the economic resources of the possessions by citizens of the United States or by U.S. corporations."

The policy of Congress has progressed from annual appropriations to meet the minimum needs of the Virgin Islands—referred to by President Hoover as

the "poorhouse" of the Nation—to a program of increasing self-sufficiency under the Revised Organic Act of 1954.

By act of October 30, 1961 (bill No. 1524) the Virgin Islands Legislature revised its Industrial Incentive statute in accordance with the limitations specified by Congress. Corporations are eligible for incentive (subsidy) benefits only if organized in the Virgin Islands and meet the requirements of Internal Revenue Code, section 934. There are minimum investment requirements; e.g., at least \$15,000 in a business of processing or producing goods; at least \$100,000 in ownership of housing projects or plants occupied by others, or in ownership or operation of hotels or guest housing. The amount of the subsidy is limited to 75 percent of the income tax liability paid to the Virgin Islands government.

The Virgin Islands government is increasingly seeking the goal of economic self-sufficiency by upgrading and diversifying its employment and economic activities.

U.S. investors have not only provided the funds for companies applying for incentive subsidies under this law, but also have supplied the funds for other corporations; e.g., owning and developing real estate. Recently, indeed, American shareholders organized a small business investment company chartered in the Virgin Islands and duly licensed by the Small Business Administration.

2. The Virgin Islands development program will be stifled and aborted by the restrictive provisions of I.R. 10650 applicable to foreign corporations unless Virgin Islands corporations are excluded therefrom: The basic congressional purpose of encouraging a Virgin Islands development program sparked by the private initiative of U.S. citizens and corporations will be stifled by various provisions inserted into I.R. 10650 to limit the flexibility of U.S. investors in truly foreign corporation in terms of getting funds for expansion.

The following is illustrative and not intended as an exhaustive catalog:

U.S. individuals and corporations could not prudently run the risk of a 10-percent investment in a Virgin Islands corporation, owned over 50 percent by U.S. persons, in view of sections 13 and 16 of I.R. 10650.

Under section 16 of the bill a U.S. stockholder, on sale of his stock or dissolution of the Virgin Islands corporation is faced with substantial risk of taxation at ordinary rates—instead of capital gains treatment—of all the post-1962 earnings of the corporation not previously imputed to stockholders.

Under 053(a) the appearance of or increase in nonqualified property in the corporation's statement becomes taxable to the shareholder to the extent of all earnings accumulated after 1962. This would paralyze an individual shareholder facing the possibility of a pillup at a 90-percent rate in some future year (and an individual has no possible benefit from foreign tax credits). A corporate stockholder would also refrain from the risk that even if its Virgin Islands operation is successful its expansion program might be stifled by such an imputed dividend. They could not prudently risk the enormous adverse tax consequences that would ensue if they should be held unable to meet the burden of showing the property is qualified; i.e., "ordinary and necessary for the active conduct of a qualified trade or business"—uncertain terms that require interpretation and concrete content.

Clearly no U.S. person will shoulder the difficulties inherent in doing business in an emerging territory, like the Virgin Islands, if he must forego the customary capital gains treatment available for any State corporation, when sale of stock or dissolution of business is indicated. (There may be many reasons: The business, once strong, may have been made obsolete. New hands with new talent, or more capital, etc., may be desirable. It may be appropriate for a U.S. stockholder to sell his stock to a Virgin Islands resident. The U.S. shareholder may need more diversification of his estate, etc.)

Even prior to sale or dissolution, section 13 of the bill confronts this U.S. shareholder with the risk of being taxed on his pro rata share of all earnings of the Virgin Islands corporation after 1962, lumped together in any future year to the extent this "foreign" corporation has property held not "qualified" because in excess of that deemed "ordinary and necessary for the active conduct of a qualified trade or business." For an individual a 90-percent tax rate might turn on whether he could meet this uncertain burden of proof. Furthermore, unless the business was carried on before 1963, or for a 5-year period prior to the taxable year, it is not a qualified trade or business unless carried on "almost wholly within a less developed country or countries." (See sec. 053(b)(3).) Even if a potential investor could assume that the Virgin Islands would stay on the list of less developed countries, the risk remains that the term "wholly

within" would be inapplicable to activities that were a natural part or growth of the business of the Virgin Islands corporation—say a vessel going to and from the Virgin Islands; or activities in the United States related to sales or purchases there.

3. Remedial provision: The Memorandum dated April 27, 1962, presented to the Senate Finance Committee by Attorneys Aldhoff et al. states (p. 22):

"In view of the development programs of Puerto Rico and the Virgin Islands, special consideration should be given to excluding corporations of those countries from the term 'foreign corporation' for purposes of sections 13 and 16 of the bill."<sup>1</sup>

A suggested approach would be insertion of a provision like the following:

"As used in this section, the term 'foreign corporation' shall not apply to any corporation created or organized under the laws of a possessor of the United States (including for purposes of this section territories and The Commonwealth of Puerto Rico) if (1) 80 percent or more of its gross income for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession as so defined; and (2) 50 percent or more of the gross income of such corporation for such period or such part thereof was derived from the active conduct of a trade or business within a possession as so defined."

Development of the economy of the Virgin Islands requires a wide range of businesses—primarily tourism and manufacturing, but also service trades for expanding Virgin Islands tourism and manufacturing companies; and other trades or businesses—e.g., financing small businesses; investing in sorely needed middle-income housing.

The amendment requested would not in any way permit the Virgin Islands to become a tax haven for foreign income. Under that amendment, as under the present Federal tax laws, a Virgin Islands corporation doing business in any foreign country would be required to pay Federal income-tax rates on that income just like a U.S. corporation doing business in a foreign country.

The only tax advantage from a Virgin Islands investment would come from the limited Virgin Islands subsidy within the framework approved by Congress to stimulate economic development by private capital.

We ask that H.R. 10650 be amended to enable U.S. citizens and corporations to invest freely in a Virgin Islands corporation doing business in the Virgin Islands without possibility of any greater tax consequence than ensues from investing in a domestic corporation doing business on the mainland.

GOVERNMENT OF THE VIRGIN ISLANDS,

RALPH M. PAIKWONSKY, Governor.

HAROLD LEVENTHAL, Counsel.

Senator ANDERSON. Without asking questions on it, if I give it to you—he has had the conversation with Mr. Surrey—would you be able to send back to me for future guidance, and other members of the committee who might desire, the effect this might have on the Virgin Islands?

Secretary DILLON. We would be glad to do that, but I do not think it is necessary, because we recommended this morning that section 13 not apply to possessions of the United States, which would include the Virgin Islands.

Senator ANDERSON. But he gave this to me a short time ago, and I thought it applies also to Puerto Rico, and I would be happy to have the answer.

Mr. Secretary, one day I raised a question about the credits that might be given for livestock under this investment credit provision.

Is it your desire to have the language in here finally giving credits to people who might buy stallions for their racing stable or breeding bulls for their herds, or would you eliminate that?

<sup>1</sup> A means of doing this would be as follows: Add to sec. 951 and to sec. 1248 (that would be added by secs. 13 and 16 of the bill) a new subsection providing in substance:

"As used in this section, the term 'foreign corporation' shall not apply to any corporation created or organized under the laws of Puerto Rico or of the Virgin Islands."

Secretary DILLON. No, Senator. We felt that your suggestion was very apt, and for the reason which was also spelled out in the statement I submitted this morning, we have recommended strongly that all livestock be excluded from credits.

Senator ANDERSON. I apologize. I was not able to be here, since I was at another meeting.

Senator McCARTHY. Senator, will you yield just at that point?

Did you recommend they be eliminated altogether? I thought it was retroactive, 3 years.

Secretary DILLON. No; livestock should be eliminated altogether.

Senator McCARTHY. Altogether, for the whole proposition?

Secretary DILLON. Yes.

Senator ANDERSON. We have been getting lots of mail about mutual savings banks, and people write me and tell me how it is going to put them out of business.

I have come to this question: In 1952 the mutual savings industry was first subjected to ordinary corporate income tax, except for special bad-debt reserves which they now enjoy.

What has been the growth of the industry since that 1952 act was passed? Can you make an estimate?

Secretary DILLON. We have given, naturally we had to give, a lot of study to this. That is a question which we went into. The figures show that at the end of 1951 the savings institutions, as a whole, had assets of about \$42.5 billion. By the end of 1961 their total assets amounted to \$125 billion. In other words, they about tripled in the last 10 years.

Senator ANDERSON. Then, would it be your testimony that the imposition of this corporate tax on that portion above their debt reserve, did not put them out of business?

Secretary DILLON. It had very little, if any, effect. It did not have any effect.

Senator ANDERSON. It went the other way. They increased very rapidly. I am not saying that is the reason for it, but at least they were able to grow during this period.

Secretary DILLON. That is right.

Senator ANDERSON. How much of the total earnings of these institutions has been retained by the savings institutions during the past decade, and how much Federal income tax has been paid by them?

Secretary DILLON. Well, they had total earnings before they made their distributions to their savers of about \$27 billion, and of this they retained as retained earnings in their business, about \$5.5 billion, and on that \$5.5 billion they paid Federal income taxes of something just under \$70 million. That means that the Federal income tax in the last decade they have paid has been something under or about 1.3 percent of their retained earnings.

Senator ANDERSON. Have any of them indicated to you that they think that 1½ percent is excessive taxation on retained earnings?

Secretary DILLON. Well, they seemed to have some difficulty with our idea that they should pay more, but I think that most of them now agree that it is fair that they should pay some more taxes. The question is how much.

Senator ANDERSON. Well, if the question is how much, and you are looking ahead, could you estimate what the total earnings of these

savings institutions would be during 1963, and how much tax they would pay on it if the existing law is not amended?

Secretary DILLON. Well, their total earnings, if there are no—in 1963 before—

Senator ANDERSON. I asked for an estimate. I realize it is an estimate.

Secretary DILLON. I would think their earnings after distributions to savers, based on what they are presently distributing, would be about \$1.2 billion, and if there is no change in the Federal law, their income tax liability would be, and they probably would pay, about \$10 million—1 percent or something less.

Senator ANDERSON. This recognizes they will have earnings of \$5 or \$6 billion?

Secretary DILLON. Yes.

Senator ANDERSON. And distribute some of that back to their savers.

Secretary DILLON. That is right.

Senator ANDERSON. And retain about a billion and a quarter, something like that, of it, and on that they will pay \$10 million in taxation if we do not change the law?

Secretary DILLON. That is correct.

Senator ANDERSON. You estimated that the bill before us would impose a tax on the savings banks of about \$200 million, and that would be about 20 times what they would pay if we leave the law alone. Do you think this tax would adversely affect the dividend and interest rates?

Secretary DILLON. Not at all.

Senator ANDERSON. Or bother the home mortgage market?

Secretary DILLON. No. We have had a careful study of that, and we do not think it will have any noticeable effect on the home-mortgage market.

Senator ANDERSON. I got one letter that pointed out if you did this, the home-mortgage market would just rise up and it would be tremendously inflated in rate because you are taking all this money away from them.

Do you think \$200 million from a group of institutions that might be able to retain over \$1 billion of earnings is going to affect the mortgage market?

Secretary DILLON. No. We think they could pay even more taxes, and should pay more than that.

Senator ANDERSON. Are you aware of any comparable area where privately owned mutual finance institutions dealing with the public are virtually tax exempt while their competitors pay regular corporate tax rates?

Secretary DILLON. Well, in this bill there is a provision to carry out what I understood was the congressional intent in 1951, to have some additional taxation on cooperatives. A lot of people, I would think, would think that was somewhat similar. It is smaller, much smaller. There is no comparison in size.

Senator ANDERSON. Mr. Secretary, my business experience is not in the same league with yours at all. I am way down on the list of it, but I do happen to be president of a little mutual casualty company, and I understand this would increase the taxes of that company to some extent. I have been president of it for 24½ years, and I naturally want to keep it where it survives.

I saw the bill they worked up, I had a computation made, and I did not think it was going to completely put me out of business.

Do you think that most of these organizations will be able to get along pretty well if the rates that you propose are enacted?

Secretary DILLON. Very well; yes, sir.

Senator ANDERSON. We put some taxes on life insurance companies and they still survive. All of them have their doors open, do they not? Some of the stock has even gone up a little bit I noticed the other day.

Secretary DILLON. That is correct.

Senator ANDERSON. I get a lot of letters about this change in real estate taxation. Depreciation is charged off pretty rapidly, accelerated depreciation on buildings, and then the building is sold after 4 or 5 years. They say this would be horrible if you made some levy on that by the provisions in this bill. Would you comment on that a little bit?

Secretary DILLON. Yes. We think this is an area of real tax avoidance. It is a real tax shelter. In fact, many real estate promoters, such as real-estate trusts, advertise in the papers urging people to invest in that kind of real estate because of the tax-shelter advantages. The problem is that in 1954, when we made available the double-declining balance, because of the theory, that equipment wore out more rapidly in the early years, it was applied to buildings, the theory is just not applicable to buildings, and-----

Senator ANDERSON. I did not hear you. You say it is not true of buildings?

Secretary DILLON. It is not applicable to buildings. They don't wear out more rapidly in the early years.

Senator ANDERSON. Don't they sometimes go up in value?

Secretary DILLON. It is generally the case that after the first 3 or 4 years of a new office or apartment building, it may be worth more than when it was first constructed, because it will then have tenants, and the bugs will be out of it, and so forth.

These are very long-lived assets.

Banks lend money on them on very long repayment mortgages. The interest deductions complete with double-declining balance depreciation results in there generally never being any profit in operating one of these buildings for the first few years because it is all used up in depreciation. Then the standard practice is that the building is sold after 4 or 5 years, and capital gain taken on this excess depreciation. We think this area needs very much to be corrected.

One way we are recommending is that for real estate of this nature there should only be straight-line depreciation, which much more accurately reflects the situation. But even that is favorable to real estate, and we had also recommended that the provisions applying ordinary income treatment to quick sales be applied in the case of real estate to any property that was sold in less than 6 years, and thereafter having the ordinary income provision apply on a descending scale so that permanent investors who had held the building, I think, for a total of 14 years would then no longer have ordinary income treatment on gains.

Senator ANDERSON. When you said after building a new building, after a few years the bugs get out of it, you are not referring to physical bugs but the way it operates?



Secretary DILLON. That is correct.

Senator ANDERSON. And you said they would not necessarily have any profits.

Secretary DILLON. They do not have profit because of the big depreciations.

Senator ANDERSON. Exactly, because of the large depreciation. The money was there, the returns were there, although it was more in the beginning.

Senator GORE. Actual profit but not a bookkeeping profit.

Secretary DILLON. That is correct.

Senator ANDERSON. Mr. Secretary, if you really wanted to find out a place where this 3- or 4-year rule applied, you might find it in the Senate Office Building of the Senate of the United States, would you not? We have a clock up there that runs. We had one up there that could not run because the hands were so heavy the works could not pick it up and carry them around. It took a while to get the bugs out of this room as it does out of the rest of the rooms, and its operation is a very good statement of what takes place.

You are only suggesting, as I understand it, that when a man builds a new building it takes him a while to find out how the air conditioning is going to work. I went through that a little while ago, and we had to just change everything all around and put ducts in other places and everything else.

Senator GORE. Will the Senator yield?

Senator ANDERSON. Yes.

Senator GORE. I wanted to point out one advantage there was to the old clock; it never became 12 o'clock.

Senator ANDERSON. As the lawyers always say, it is 11 until it becomes 12. It had certain advantages. We were going to finish up by 1 o'clock, as the chairman has warned me.

Now on the question of withholding—and I am going to be very brief on it, Mr. Chairman—but I operated a small business at one time that started out as a one-man business, and I had a good many accounts.

Now, they said that if I had this automatic processing machinery I would find out who owed me the money. But that would not collect it, would it, Mr. Secretary?

Secretary DILLON. No.

Senator ANDERSON. I had my books and they told me exactly who owed me money, but I found I had to wear out several pairs of shoes in the early days to get the money from the people who owed me the money.

Secretary DILLON. That is correct.

Senator ANDERSON. As I stayed longer in the business and got somewhat larger accounts, people who had more business, they paid with a little more regularity, perhaps, but a lot of small accounts were hard to collect.

You read about a prizefighter who owed the Government about \$1 million in taxes. If we had some sort of withholding on sports ventures we might have had some of that money; might we not?

Secretary DILLON. Yes, sir; I guess so.

Senator ANDERSON. And he would have been better off, much better off.

Secretary DILLON. That is correct.

Senator ANDERSON. He would not have had all the people borrowing money from him and harassing him as he did have.

We had withholding on wages, and while there may be differences, people who objected in the beginning at the bookkeeping are somewhat accustomed to it now.

Don't you find that businesses find they can handle these things by the things they put in their operations in their own business?

Secretary DILLON. There is no doubt about it. There would be no problem at all, once it was in effect.

Senator ANDERSON. If you allow a man to owe part of the money that was due on his wages, sometimes he moves to another job, and don't you have difficulty tracing him in order to collect from him?

Secretary DILLON. There are problems of that nature.

Senator ANDERSON. I remarked earlier, I do not know whether you were testifying, Mr. Secretary, but I was appointed to administer a State sales tax in my home State, and every merchant was presumed to be honest. He was sure to report all the things that he sold. But finally I prevailed upon the Bureau of Internal Revenue to let me have copies of the reports they had made to the Government, and I wrote them all and said "I am going to match your return against the Government return." I got more amended returns the first month than we had had in 10 years previously, or I mean subsequently, because a lot of them remembered a lot of things they had not reported.

They are good, honest people, but they somehow made a different report to the State. If you collected these things in advance they cannot do that; can they?

Secretary DILLON. That is right.

Senator ANDERSON. I am not very enthusiastic about withholding, I do want to warn you of that, but just the same I can recognize there might be very substantial savings, and if this is a bill to plug loopholes, here is a loophole you estimate would be what, \$600 million?

Secretary DILLON. That is on the basis of the 1959 figures. By the time this bill goes into effect it will be much larger, I should think.

Senator ANDERSON. I also want to say I think the estimate the chairman of this committee used on the Senate floor on the night he was having a great deal of difficulty having the bill passed may finally prove to be true. I think when we get all of these automatic computations and everything else we will find a tremendous lot of people avoided taxation, not always because they did not feel they ought to pay it, but they had been told it was subject to certain deductions.

A building and loan association limits the deposits—well, I should not say it that way. The amount of deposits that is insured in the average building and loan association is about \$10,000; is it not? I think that is the maximum of Federal insurance.

Secretary DILLON. I think that is right.

Senator ANDERSON. They pay four or four and a quarter or 4.6, depending on where you live, so they get about \$425 or \$450 in interest.

Does the building and loan have to report anything under \$600.

Secretary DILLON. No only \$600.

Senator ANDERSON. So almost every deposit that exists in a building and loan association is not now subject to reporting.

Secretary DILLON. That is correct.

Senator ANDERSON. If this law goes through it would be subject to reporting.

Secretary DILLON. It would be subject to withholding, yes.

Senator ANDERSON. I mean subject to withholding. If they hold it, it is bound to be reported.

Secretary DILLON. Right.

Senator ANDERSON. And you will eventually get it.

I think I have no further questions.

Senator DOUGLAS. Would the Senator yield before he closes?

Senator ANDERSON. Yes.

Senator DOUGLAS. I notice that the Secretary said that his estimate was that we were losing \$800 million in taxes on dividends and interest, which was based on the 1959 data. I wonder if you have any figures for 1960, tentative figures for 1960?

Secretary DILLON. Well, the tentative figures generally come in about this time of the year, and the figures that we have used and stuck with so far are the 1959 figures, because they were the ones that we submitted a year ago.

But we do have a first estimate of a gap for 1960 which indicates that there has been an increase in the reporting gap of about \$300 million in the case of dividends, and about a similar amount in the case of interest or a total increase of about \$600 million from 1959 to 1960.

Senator DOUGLAS. Well, now, I am not quite certain. Is this an increase in the gap or an increase in the reporting?

Secretary DILLON. This is an increase in the gap.

Senator DOUGLAS. In the gap.

Secretary DILLON. Yes.

Senator DOUGLAS. Well, now, as I remember it, your figures were that the gap in 1959 amounted to \$3.6 billion.

Secretary DILLON. About \$3 billion.

Senator DOUGLAS. A little over. Was it not \$3.6 billion?

Secretary DILLON. Well, there are two figures. There is a figure of the nonreporting gap, and you are quite right, it was just under \$4 billion.

Senator DOUGLAS. That is right.

Secretary DILLON. Then there was a figure just under \$3 billion, which was the proportion of that gap which we feel belonged to taxable individuals. Those are the two figures.

Senator DOUGLAS. I understand. The total has increased about \$3.6 to \$4.2 billion.

Secretary DILLON. To something over \$4 billion.

Senator DOUGLAS. Something over \$4 billion.

Secretary DILLON. Yes, it would be more than \$4.2 billion.

Senator DOUGLAS. More than \$4.2 billion?

Secretary DILLON. Yes. I think the figure before was \$3.8 billion and I think it would go up about \$600 million, and this would be \$4.4 billion.

Senator DOUGLAS. I wonder if the Senator from New Mexico would permit me to ask one more question on this subject.

There is a former president of the Mid-West Stock Exchange in Chicago, a Mr. George E. Barnes, who has charged that the tax collection gap on dividends is in reality nonexistent because he states that the Treasury erred in vastly underestimating the amount of dividends

received by pension funds, colleges, welfare institutions, and other tax-exempt institutions.

Now, this has been given a great deal of publicity in the Chicago press, at least. The Chicago Daily News says that if one is reluctant to believe that a Cabinet officer will attempt to bolster his case with phony statistics he might recall the case of Defense Secretary McNamara in the recent steel imbroglio, and then states that Secretary McNamara was guilty of the wildest exaggeration, and the editorial concludes with this statement:

Unless the fact of extensive tax cheating can be demonstrated conclusively, the case for withholding collapses. Right now, that seems to be the situation.

Now, this is a very important issue, and I wondered if either you or your staff have dealt with this criticism, whether you are ready to make a reply to it and, if not, whether you would submit a reply when we meet next time?

Secretary DILLON. I would be glad to. We have prepared a reply in a letter to Mr. Barnes.

We think he has made at least two very serious errors in his calculations, and we point out in detail what they are.

I will be glad to furnish a memorandum for the record because it goes into the detailed criticism. It answers Mr. Barnes' charges.

(The document referred to follows:)

**TREASURY MEMORANDUM IN REPLY TO PUBLIC STATEMENTS BY MR. GEORGE E. BARNES OF CHICAGO, ILL., WITH REGARD TO DIVIDEND NONREPORTING**

This is in reply to Senator Douglas' request for an analysis of the statement by Mr. George E. Barnes of Chicago, Ill., in the press that the Treasury has been misrepresenting the size of the dividend nonreporting gap before the Congress.

Mr. Barnes has also made this charge in a letter to Secretary Dillon. He notified the Secretary that it was his intent to call congressional attention to the Treasury's misrepresentation by filing a statement with the Senate Committee on Finance. Yesterday Secretary Dillon mailed his reply to Mr. Barnes.

Mr. Barnes claims that the 1959 dividend nonreporting gap calculated by the Treasury is almost nonexistent, according to his estimates, because the Treasury had made a serious error by underestimating the amount of dividends received by corporate pension funds and other tax-exempt organizations.

In fact, Mr. Barnes made several errors in his estimates; these were pointed out in Secretary Dillon's reply. When Mr. Barnes' estimates are corrected, his figures and the Treasury's figures are in substantial agreement.

First, Mr. Barnes made an error in calculating dividends received by pension funds and tax-exempt organizations when he applied an estimated yield to stockholdings at the end of the year rather than to average stockholdings for the year. Because of the relatively rapid rate of growth of these funds, Mr. Barnes overstates by more than 10 percent the estimate of dividends received by tax-exempt institutions.

Mr. Barnes' second error is also very serious. He assumed, based on the proportion of all dividend disbursements to those made by New York Stock Exchange listed companies, that the total stockholdings of tax-exempt institutions are \$41.4 billion, of which \$24 billion represent New York Stock Exchange listed securities. This figure is entirely out of line. For instance, in the case of pension funds, Securities and Exchange Commission data show that total stockholdings of pension funds as of the end of calendar year 1959 were \$12.9 billion—\$1.8 billion or 16 percent greater than \$11.1 billion figure. Mr. Barnes uses data from the 1959 New York Stock Exchange survey.

The Securities and Exchange Commission data are logical since it is apparent that pension funds for the most part hold only the highest grade securities in their portfolios and these consist of stocks listed on the New York Stock Exchange.

Mr. Barnes estimates that pension funds and tax-exempt organizations hold \$24 billion of stock listed on the New York Stock Exchange. Mr. Barnes' cal-

ulation of total holdings of such organizations, if corrected, runs as follows: His \$24 billion of tax-exempt institutional stockholdings times 110 percent (blow-up for non-New York Stock Exchange holdings) times 90 percent (midyear rather than end of year) equals \$25.1 billion of stockholdings.

Applying Mr. Barnes' yield rates (median of all New York Stock Exchange dividend-paying listings) to the \$25.1 billion of holdings, his corrected figure equals \$971 million of dividends received by pension funds and tax-exempt organizations. This is only \$90 million higher than the Treasury estimate. In fact, Mr. Barnes' figure would come even closer to the Treasury if he had used the Moody's average yield on 200 stocks which the Treasury believes to reflect more closely the types of stocks held by tax-exempt institutions.

In summary, the Treasury is satisfied that the dividend and interest non-reporting gaps are real and serious. All studies by the Treasury, congressional committees, and outside experts, including technicians of the New York Stock Exchange, show consistently that substantial underreporting exists.

Correction of Mr. Barnes' data :

	Mr. Barnes' data	Mr. Barnes' data corrected
New York Stock Exchange listed stocks held by pension funds and tax-exempt organizations at end of calendar year 1959.....	\$24,000,000,000	\$24,000,000,000
Ratio of total holdings to holdings of New York Stock Exchange listed stocks <sup>1</sup> .....	100:68	116:100
Total stockholdings of pension funds and tax-exempt organizations.....	\$41,400,000,000	\$27,800,000,000
Correction for mid-year rather than end of year holdings...percent.....		90
Average stockholdings for 1959.....	\$41,400,000,000	\$25,100,000,000
Yield computed at 3.8 percent and 5.1 percent.....	\$1,600,000,000	\$971,000,000

<sup>1</sup> Mr. Barnes used ratio of all dividend disbursements to those made by New York Stock Exchange listed companies. Securities and Exchange data on stockholders shows that for pension funds and tax-exempt organizations the ratio is not 100:68 but 116:100.

<sup>2</sup> Compares with Treasury estimate of \$380,000,000 which was computed at lower yield rates based on Moody's 200 stock index.

Senator ANDERSON. If the Senator from Illinois is finished, I only want to say, Mr. Secretary, I just wonder sometimes if this flood of mail that is just inundating every senatorial office does not indicate that a lot of people are frightened with the prospect of paying income taxes on interest and dividends. I draw no other conclusion from those people who write to me and who say, "You are talking about taking away all my bread and butter. I only have \$100 income, and you want \$20 of it."

Someone has grievously misrepresented the situation.

Secretary DILLON. That is right.

Senator ANDERSON. I write back and I say, "If you only have \$100 income, you do not have to pay income tax at all, and the very first time you can simply have that eliminated from your taxpayments."

But somebody has circulated a lot of information. I begin to wonder if there are not people who perhaps are worried about whether they will have to start paying taxes on interest and dividends.

Secretary DILLON. I agree.

Senator ANDERSON. Thank you.

The CHAIRMAN. Any further questions?

(No response.)

The CHAIRMAN. The committee will adjourn until 10 tomorrow morning, and the Chair will call on those Senators first who had not asked questions.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 10 a.m., Friday, May 11, 1962.)



# REVENUE ACT OF 1962

FRIDAY, MAY 11, 1962

U.S. SENATE,  
COMMITTEE ON FINANCE,  
Washington, D.C.

The committee met, pursuant to recess, at 10:10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman), presiding.

Present: Senators Byrd (chairman), Anderson, Douglas, Gore, McCarthy, Hartke, Williams, Curtis, and Morton.

Also present: Elizabeth B. Springer committee clerk; and Colin F. Stam, and L. N. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

According to the policy of giving those Senators who have not had an opportunity to question the Secretary in their order, the Chair recognizes Senator Curtis.

Senator CURTIS. Thank you, Mr. Chairman.

Mr. Secretary, I have a number of points I am very much interested in and I will try to be concise. I have a couple of questions that are general in nature and not related directly to this bill, but the Congress has certain responsibilities in a follow-through of the legislation they enact under the Reorganization Act.

The New York Times on April 16, 1962, has a study on the steel situation.

In it I find this paragraph, referring to the Internal Revenue Service. It says, and I quote:

Agents of the Chief Counsel's Office of the Internal Revenue Service were ordered on Wednesday to make an intensive check of U.S. Steel's option plan which has existed for years to give incentive benefits to the company's executives.

Were such orders issued?

## STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE U.S. TREASURY—Resumed

Secretary DILLON. I know of no such orders.

I wasn't in Washington at that moment, and I never was informed that any such orders were issued. I very much doubt that that is a correct statement.

Senator CURTIS. Would you say that they were not given?

Secretary DILLON. To the best of my knowledge they were not given. If you ask me to inquire, I will make an inquiry.

Senator CURTIS. Have you inquired up until now?

Secretary DILLON. I have not made a formal inquiry, because I just assumed it was not true.

Senator CURRIS. Had you heard this before.

Secretary DILLON. I had not heard it before. I did read this great long article in the New York Times and noticed it there. I had also seen a number of statements in the press that we had considered changing or given orders to consider changing the depreciation provision and all that sort of thing. This was a totally inaccurate story.

Senator CURRIS. Will you check on it and report to this committee?

Secretary DILLON. I would be glad to.

My understanding is that it is totally inaccurate, but I will be glad to check it.

Senator CURRIS. And by order, I am not referring to a written formalized order. I want to know whether or not such activity was instigated at this time.

The other sentence in the same paragraph is along the same line and it says, and I quote:

Investigators of the tax agencies intelligence division reportedly began an audit of the tax reports of other top steel executives.

Do you know whether that is correct?

Secretary DILLON. I am sure that can't be true, but I will give you a formal report on that, too.

Senator CURRIS. Yes.

If you find anything along this line was done, I would like not only a report, but I would like to know what official is responsible for it.

Secretary DILLON. I do know that in that whole period there was never any discussion or any indication from any source in the Government that the Treasury should use any unusual enforcement procedures or investigations to bring pressure in that way on the United States Steel Corp. or any other steel company.

Senator CURRIS. Then, is it your position that the tax arm of the United States was neither used nor threatened to be used in connection with the steel controversy?

Secretary DILLON. By the Treasury, that is correct.

Senator CURRIS. No, by anyone.

Secretary DILLON. I am sure it was not threatened to be used by anyone, but I am sure there was some misinformation which I read in the newspapers indicating that it had been. But that is just not correct.

With reference to the statement in the New York Times on April 16 that "Investigators of the tax agencies intelligence division reportedly began an audit of the tax reports of steel executives," the reports referred to are inaccurate and without basis. At no time during the period of the steel price increase incident did the Treasury Department or the Internal Revenue Service initiate any new tax enforcement procedures or investigations designed to bring pressure on the United States Steel Corp. or any other steel company. Nor was the tax arm used or threatened to be used in connection with the steel price controversy.

With reference to the other statement in the New York Times that "Agents of the Chief Counsel's Office of the Internal Revenue Service were ordered on Wednesday to make an intensive check of U.S. Steel's



option plan which has existed for years to give incentive benefits to the company's executives" the following are the facts:

(1) As indicated in the testimony before the Senate Finance Committee on April 2, the Treasury had for some time—long before the steel price incident—been conducting a broad study of the operation and implication of stock options in the course of its tax legislative policy review. In connection with this study we had obtained from the public records of the Securities and Exchange Commission some data on the stock option plans of a large number of industrial corporations, including the United States Steel Corp.

(2) At the time of the steel price increase the Treasury tax policy staff, with the assistance of a member of the legislative staff of the Chief Counsel's Office of the Internal Revenue Service, assembled, from the public records of the Securities and Exchange Commission, a brief up-to-date factual analysis of the principal provisions of the United States Steel Corp.'s stock option incentive plan and the number of shares subject to outstanding option held by executives of the corporation.

(3) This information was sought solely to inform the Treasury staff of the status of these options in making an appraisal of the factors that might be relevant to the steel price increase. This was simply a part of the process of obtaining full information about all aspects of the steel industry, so as to obtain as broad a perspective as possible in assessing that increase.

(4) After the material was reviewed no further use was made of it in connection with the steel price increase situation, beyond providing a copy to a member of the Council of Economic Advisers.

Senator CURTIS. Now, coming to the bill directly, on page 9, the first line of your statement—

Secretary DILLON. Was that yesterday's statement?

Senator CURTIS. Yes, yesterday's statement.

Your mimeographed copy that I have, it is the bottom of page 9, line 1.

Secretary DILLON. Yes.

Senator CURTIS. Really lines 1 and 2. You used the term "tax haven companies."

Will you define a tax haven company?

Secretary DILLON. What we have done is not to define a tax haven company specifically, but to define in effect a tax haven transaction. For example, a tax haven transaction is one where a company incorporated in country A purchases from country B and resells in country C.

So in this situation there have to be three countries involved and the use of the words "tax haven company" is just a short description of companies which operate in this way. We do not have a definition of a company as a tax haven company.

Senator CURTIS. I understand it is not in the proposal, but this is presented to the country and to this committee as reference to a tax-haven company, and there are people in Congress and out that are concerned about tax haven companies.

So, I would like to have a definition of the company you are speaking about when you use this term, not the name of the company but what constitutes a tax haven company.

Secretary DILLON. Well, I have already given a definition to the Senator. It means companies that operate in the way I have described, that are domiciled in a country, generally a very low tax country; that do business in two other countries. We can give you a list of names of these countries if you desire.

Senator CURRIS. Now, a tax haven company is one that does business with two other companies in two other countries.

Secretary DILLON. What I have said is that in a tax haven transaction where there are two other countries involved, and one of them may be the United States.

It is also a transaction where income for a service, a commission for an item sold, a royalty for a patent, anything you wish, is received from one country by a corporation incorporated in another country.

Senator CURRIS. Now, are all such operations that you have described tax haven transactions?

Secretary DILLON. Not all such operations are necessarily tax haven transactions, and that is the specific reason why I requested in the statement I made yesterday that the Secretary of the Treasury be given authority to exempt specific transactions, specific operations that are not entered into for the purpose of tax avoidance.

I would say that three-quarters or 90 percent of the transactions that I have described are for the purpose of reducing taxes and would be tax haven transactions.

But there are some, and I can give you examples, which are not.

Senator CURRIS. Give me an example of one that is.

Secretary DILLON. One that is?

Senator CURRIS. Yes.

Secretary DILLON. A classic example of one that is, is a U.S. foreign subsidiary which has a manufacturing plant in England to make anything, condiments, if you will. It sells all its condiments that it sells on the continent first to a U.S. controlled Swiss sales corporation. They never go to Switzerland, but they are marketed in France, Germany, Belgium, everywhere else as the property of the Swiss sales corporation. The entire profit is lodged in Switzerland. The manufacturing company in Great Britain is paid a very small figure for the wholesale value and makes a minor profit.

That is the type of operation that clearly is a tax haven operation.

Senator CURTIS. Where does the U.S. Government come into the transaction you described?

Secretary DILLON. Where the United States comes in, in that transaction, is that these would be controlled foreign corporations the control of which is in the U.S. parent corporation.

Senator CURTIS. Now, in this hypothetical case which you describe how many of those transactions would have transpired in the United States?

Secretary DILLON. Would have transpired in the United States?

Senator CURTIS. Yes.

Secretary DILLON. I don't understand your question.

This is a manufacturing company in England operating through Switzerland to sell in France. The connection is the U.S. ownership.

Senator CURTIS. But it is income to the corporation or is it income to the stockholders?

Secretary DILLON. Under the philosophy of the foreign personal holding company provisions, the Congress has decided and the courts have upheld that where transactions are entered into for the purpose of avoiding U.S. taxes, the income can be imputed to the U.S. stockholders and that in effect is what is happening here.

Senator CURTIS. That is a personal holding company?

Secretary DILLON. That is what it is by definition.

Senator CURTIS. I thought you were describing an actual operation of manufacturing and sale of goods throughout Europe.

Secretary DILLON. There is no legal constitutional difference, and we are following the exact same procedure here. We apply the same procedure to these other operations as has been applied for many years to foreign personal holding companies.

Senator CURTIS. But suppose that the parent company in the United States is a publicly held corporation and not at all in the category of a personal holding company, and it has many stockholders, is income either to the—is income to the subsidiary income to the stockholders of the parent corporation.

Secretary DILLON. We look on a parent corporation as a U.S. person under the law, and the income is imputed to the U.S. person who controls the foreign subsidiary, and that person would be the U.S. parent corporation.

Senator CURTIS. Now suppose this company in this hypothetical case you describe was set up for the purpose not of evading taxes on income earned under the American flag but was for the purpose of finding a market, developing a market that could not be developed by the parent company located in the United States.

Would that change the situation?

Secretary DILLON. I certainly recognize that there are markets that can best be developed by investment abroad. But we do not feel that it is necessary to have as an added inducement and an added factor in that development the tax inducement of partial or complete tax exemption that flows from the use of tax havens. We think that the same markets could be developed by paying a reasonable tax.

Senator CURTIS. They do pay a tax when the money is brought back do they not?

Secretary DILLON. A tax is paid when the money is repatriated to the United States; that is correct.

Senator CURTIS. Now, speaking of operating companies that actually engaged in manufacturing, processing, selling, all of that activity is outside the United States, isn't it true that heretofore we have adhered to a jurisdictional principle that a tax so earned outside of the United States—the United States tax on income earned outside the United States—is due when it is remitted to this country?

Secretary DILLON. That has been the principle in the law, except for the foreign personal holding company law.

Senator CURTIS. And this proposal would greatly change that, wouldn't it?

Secretary DILLON. This proposal would very considerably modify that principle. That is the purpose of it.

Senator CURTIS. Now, you referred a moment ago to suggestions made yesterday to grant to the Treasury Department authority to by regulation—although you didn't use that word—except certain

transactions or make a finding that they were not tax-haven transactions?

Now——

Secretary DILLON. That is correct.

Senator CURTIS. How is the business concern going to know what the rule of the Treasury would be 5 years from now?

Secretary DILLON. By coming in and asking.

Senator CURTIS. When? Now?

Secretary DILLON. Now.

Senator CURTIS. Would that answer be binding upon the Treasury 5 years from now?

Secretary DILLON. We would be prepared to give rulings on this sort of thing very generously ahead of time because we do not want to upset business and we don't want to have uncertainty here. We would be very glad for any business that thought it had a case to come in and talk to the Internal Revenue and we would give them a ruling in a proper situation.

Senator CURTIS. Well, I am glad you share the view that this is a decided change in the tax policy of the country.

One of the things I had in mind late yesterday afternoon when I requested that a new bill be drafted and printed as a study bill, study copy, was so that it could be examined, and to see what the proposal is made in our basic tax philosophy and practice in the light of your modified recommendations of your statement yesterday.

Now, I will come back to some more questions on this line in a moment, but I want to ask you what do you regard as the basic purpose of our tax laws to be. Is it the raising of revenue or is it to direct the course and policies of business?

Secretary DILLON. I think that our tax laws have always had two basic purposes: One, and the fundamental one is the raising of revenue; the second and equally important one is the raising of revenue in a way that is equitable, socially equitable, and also helpful to our general economy.

Those are both co-equal.

If it were not for the latter, we probably wouldn't have the progressive income tax which we have had since 1913 and which was put in for that reason.

Senator CURTIS. Now, if a concern is established abroad as a subsidiary of an American, a domestic company, and there have been cases where those subsidiaries have been established by earnings, with the use of earnings made abroad, and they produce income abroad, and they establish further subsidiaries abroad, to expedite the sale of products made abroad, ultimately that increases the flow of money, gold, and affects our trade balances favorably to the United States, does it not?

Secretary DILLON. At some ultimate date in the future that would be true. But looking back over the past 12 years, it hasn't been the record. Because of these various tax inducements the new outflow has increased just as fast as the additional earnings that are being sent back, so although we have had a very dramatic increase in the total value of our investments overseas, we have not yet realized on that in a net fashion in the balance of payments.

Senator CURTIS. You are talking then about the fact that it takes time after an investment is made before it shows a profit?

Secretary DILLON. Yes; but I think you must look at this on an overall basis. Since we have \$50 billion of private holdings, direct and portfolio, abroad, we should be beginning to get some substantial net benefit out of this in our balance of payments when we need it very badly. That is not yet the case.

Senator CURTIS. I do not have the figures right before me but I cited them on the floor the other day indicating that a report issued in 1960 showed a net gain in favor of the United States.

Secretary DILLON. There is a small net inflow overall but it is nothing in comparison to the \$50 billion figure.

Senator CURTIS. But there is a net gain.

Secretary DILLON. Which flows primarily, as you have so well pointed out, from older investments that have been outstanding a long time, and in particular from investments in underdeveloped countries, which are in extractive industries of one form or another.

They are the biggest income returners to the United States at the moment.

Senator CURTIS. What power does the Internal Revenue have at the present time to deal with a tax haven?

Secretary DILLON. Effectively no power.

Senator CURTIS. Now—

Secretary DILLON. One reason for this is that in practically every case where we have felt that there had been action by companies which would approach the area of fraud, when we asked to see the books which would be necessary for an investigation, they can successfully hide and they do hide behind the fact that these countries such as Switzerland refuse to make figures available. They invariably refuse to make their books available to the Internal Revenue Service.

Senator CURTIS. Now, a long procession of American business concerns have testified before this committee in the past weeks against the provisions dealing with income earned outside the United States.

Are you familiar with that testimony?

Secretary DILLON. I have read excerpts from all of it.

Senator CURTIS. Now, the transactions those witnesses were talking about, were they tax-haven transactions?

Secretary DILLON. Some of them were and some were not.

Senator CURTIS. What ones were not?

Secretary DILLON. Well, I don't consider manufacturing abroad a tax-haven transaction. There was a lot of discussion about this general principle of deferral, and a feeling that we should not impose U.S. taxes, in effect, on a company that was merely manufacturing in Germany. That has nothing to do with tax havens.

Senator CURTIS. At what point does that become a tax haven?

Secretary DILLON. The point I described, where the company, instead of marketing its products directly either in other countries, such as marketing in France through a French subsidiary or in Italy through an Italian subsidiary, chooses to market its entire product, or the bulk of it, through a Swiss subsidiary, where, as it is well known, effectively no taxes are paid. This is done primarily for tax purposes.

Senator CURTIS. Well now, in the illustration you just cited, isn't it true that if any tax is evaded it is evaded in the other European countries you described rather than in the United States?

Secretary DILLON. It reduces the overall tax rate of the manufacturing and selling operation, so that it is very substantially less than the tax rate for a similar operation here in the United States. It provides a very substantial inducement to manufacture abroad rather than in the United States.

Senator CURTIS. If they lower the tax liability abroad in one country or two or three countries, how does that affect the revenue in the United States?

Secretary DILLON. If they lower the tax liability? I don't quite understand the question.

Senator CURTIS. If an operation is carried on in one, two, or three countries of Europe resulting in manufacturing over there and selling, if the operation abroad lowers their foreign tax how does that hurt the Treasury of the United States or the United States?

Secretary DILLON. I understand now.

When you have a very substantial tax inducement, which is what results through the use of tax havens in conjunction with deferral, there will be a number of marginal cases, and they will come to a substantial amount. I think I estimated the figure in my original statement as some \$400 million a year, where funds will be kept abroad or sent abroad, rather than invested here in the United States.

There are exports which can only be sold from Europe; there are other exports which can be sold either from Europe or the United States.

In the case of a very substantial tax advantage abroad the company naturally and quite rightly will choose to go where it can make the most profit. That is what our system is for. They, therefore, will go to Europe rather than remain in the United States. Under our present circumstances of unemployment and payments imbalance I think that is highly undesirable. It is desirable that the maximum possible be exported from the United States directly, wherever that is possible.

Senator CURTIS. In that connection, do not these manufacturers manufacture in West Germany, some business is transacted in France. But another corporation is created in Switzerland to handle all of this, and as a result a smaller amount of tax is paid in West Germany and in France.

Secretary DILLON. That is correct.

Senator CURTIS. And in Switzerland there would be if it were all handled in Germany, and doesn't that mean that there are more earnings that can be remitted to the United States.

Secretary DILLON. Well, the fact is that they are not remitted to the United States.

Senator CURTIS. They haven't been earned here, have they? They haven't been earned under the American flag, have they?

Secretary DILLON. They are earned by American controlled subsidiaries.

Senator CURTIS. A subsidiary is a person, is it not?

Secretary DILLON. That is right. The facts show, I think, that whereas manufacturing subsidiaries abroad, in general, transmit to

the United States out of their earnings something like 45 percent on the average—that is a rough figure: it may be one or two percentage points or lower—as compared to dividends payouts in the United States which approach an average of 55 percent, when it comes to the tax-haven area the amount of funds repatriated to the United States as dividends by companies incorporated in countries we have come to know as tax havens amounts to something in the order of only 15 percent of their profits. That is why I say these profits are not repatriated to the United States.

Senator CURRIS. Well, now, Mr. Secretary, if there is an available market in a foreign country, and the only way that market can be reached is by a company being established in that foreign country, and this is not theoretical because many of these countries insist that their own citizens and nationals have a part in the operation, the country in which the parent corporation is located is going to benefit by a continuous flow of exports in that country, are they not?

Secretary DILLON. You mean that when an American company is located in France, the United States will have a flow of exports to it?

Senator CURRIS. Yes, sir.

Secretary DILLON. The figures, which are shown in great detail in exhibit III with my original statement, show there are some exports generated, that for every dollar invested in Europe about 8 cents a year worth of exports are generated.

Senator CURRIS. Well, let's take the case of a country in Latin America.

Suppose that country has a policy that any business concern established there must have a local participation, and suppose that the competition over the question of who establishes that plant down there is between West Germany and the United States.

Suppose West Germany wins the competition and establishes the concern. Raw materials, component parts, repairs, the establishment of an acquaintanceship, and a know-how, good will down there will all inure to West Germany and not the United States, isn't that true?

Secretary DILLON. That is correct. That is why we don't propose to have these provisions apply to less-developed countries.

Senator CURRIS. Who is going to determine whether a country is developed or underdeveloped?

Secretary DILLON. The developed countries are listed by name in the law, and we presume that all the rest will be considered underdeveloped. That is what the law provides; the President, I think, has that authority, but that is not a vital element of this bill. That could be provided any other way that your committee might find useful.

There was some discussion, as you will recall, yesterday, about establishing some criteria. The Senator from Oklahoma made what I thought was a very good suggestion, that in case any company made an investment in a less-developed country, it be given the assurance that for a period, say, of 2 years there would be no change in status as respects that investment no matter whether the status of the country was changed for other, new investments or not.

And I think that that sort of thing is technical and can and should be worked out so that it will not restrain investment.

Senator CURRIS. Well, I have had laid before me the case of a Nebraska corporation that is in the business of processing and export-

ing grain, feed, mixed feed. It is making a contribution to one of the Nation's most serious problems of agricultural surpluses.

It has made tentative arrangements to establish a subsidiary in each of two Latin American countries. They are required in both countries to have some local participation.

Part of the contract with those local people is a provision that all the earnings will be plowed back for a period of 5 years. Their conversation with me was before your statement yesterday. They were of the opinion that if these provisions of this bill relating to foreign income were enacted, that they would not go through with either transaction.

Many good lawyers, many businessmen, concur in their theory of fears. You say their fears are totally unfounded.

Secretary DILLON. All my suggestions yesterday were meant to be and were responsive to arguments that had been raised in hearings here.

We didn't bring in totally extraneous things at all. This was one of the things we dealt with. On page 14, section 5, where we talk about liberalizing the use to which earnings of operating companies in less-developed countries may be put. We recommend that there be complete freedom as to the manner in which such earnings may be employed.

So I don't see that that would be any different from the situation that exists now, and I would, therefore, think that the fears of your constituent, which may have had some foundation as the bill was drafted before should now be completely dissipated.

Senator CURTIS. Now, Mr. Secretary, aren't we dealing with about three categories here, and ending up in confusion in the business world and in Congress and elsewhere by putting them all in one ball of wax?

We have a situation of incorporated pocketbooks. The clear and pure case of tax avoidance by seeking a jurisdiction to locate and conceal income that belongs in the United States, I know of no opposition to any reasonable move to deal with that.

We also have, and this is a small group, concerns that may establish plants, with American capital, in foreign countries for the purpose of supplying a domestic market, not many of them.

There are a few.

A jeweled-watch factory at Lincoln, Nebr., that a few years ago was employing 2,000 people is now located in Japan, not to sell the Japanese watches, but to sell watches to the United States.

That is a different category and perhaps some of the remedy for that lies through trade and tariff legislation; I do not know.

Then we have the operating companies that go into a foreign country for business reasons, to supply and avail themselves of a market abroad that they cannot reach at home.

Now, isn't this latter group that I have mentioned, the largest group?

Secretary DILLON. I think it is, Senator, very clearly. In our testimony and figures, we have indicated that we feel the results of this legislation, even if you have complete elimination of deferral, would only reduce investment by some 10 percent in the developed countries. That is where the figure of some \$400 million came from. This should give us a total new investment there, of funds flowing out of the



United States and of reinvested earnings, which comes to approximately \$4 billion.

So that isn't a very large proportion. We think that 90 percent of the companies would not have tax thoughts uppermost and would be doing this for good business reasons, and would continue to do it. We would then be assured that these were good business operations.

All we want to do is to remove the tax-inducement factor that may have played a part in such things as you have mentioned, like the moving of a very large watch factory from Nebraska to Japan with the loss of 2,000 jobs in Nebraska.

Senator CURTIS. Yes.

But now that is a small area of our foreign activity and as I say there are other remedies that can be applied and may be even some tax remedies.

Secretary DILLON. I think that area will grow and grow very rapidly if our tariffs are reduced, as we plan, if the present trade bill is passed. Indications are that it will be easier to import into the United States from abroad. Therefore, it becomes more important to reduce the tax incentive to move abroad.

Senator CURTIS. Well now, let's talk about the establishment of a subsidiary in a developed country.

Suppose there is a market available in France that we cannot reach by goods being manufactured in the United States, and so a U.S. concern, a publicly held corporation, establishes a subsidiary in France to supply that market.

Is it not true that there would be considerable exports to France generated by that, including some raw material, some machinery, component parts, some repairs.

Hasn't that been the history of these things?

Secretary DILLON. The history, as shown in the Department of Commerce figures, is that for every dollar invested that way, a maximum of 8 cents of exports will be generated annually. Whereas, as you pointed out quite correctly, for investments in Latin America where local facilities are not as good, the story is quite different. There would be something like 40 cents of exports developed.

Senator CURTIS. But it would increase the exports from the United States.

Secretary DILLON. By an amount which I would not consider large, by a very small amount. When you look at this thing in the whole, and include those companies that move abroad and sell back here (which I agree are a minority) that is an offset. We figure that the net increase varies between zero and 4 percent, based on Department of Commerce figures.

Senator CURTIS. Well now, isn't it also true that if a parent company in the United States has a subsidiary and makes a successful operation in France, that that leads to acquaintance in the French business community, that it gives rise to a sales force all of which is beneficial to the United States in employment in the United States.

Secretary DILLON. To the extent there are new exports generated from the United States it is beneficial to the United States.

But the figures show that this is very small for Europe.

I want continually to draw that line, because in the underdeveloped countries, the Department of Commerce figures show a very different picture.

I want to make it very clear that I am not against these investments in Europe, when they are based on economic considerations. I think that those should continue. I think they will continue, and I think they are helpful.

We are trying to reduce or eliminate the special tax incentive which may make certain businesses transfer their operations to France rather than have the same operation here, and to encourage exports from the United States rather than from European production.

Senator CURRIS. In that connection, do you base that statement on an assumption that there is not enough capital to go around to build plants in both the United States and in the foreign countries?

Secretary DILLON. No.

I base it on just wanting to keep jobs for the employees of that watch company in Nebraska.

Senator CURRIS. No, no.

I do not think that is the situation at all.

I said there is an isolated group, a small group, that may move a factory abroad to supply domestic markets, but I believe all the figures will indicate that that is a very small portion.

Secretary DILLON. I agree with that.

Senator CURRIS. In the area we are talking about, and a remedy can be applied to that situation in the consideration of the trade and tariff bill without putting all these other companies through the wringer.

Secretary DILLON. I see no way in which a remedy can be applied in the trade and tariff bill. Situations of this sort will become more frequent as our tariffs go down. All we want to be sure of is that these increased imports, which are bound to have some effect on our own production, are based on pure economic considerations, and are not based in any way on tax considerations.

Senator CURRIS. Now, what is in the bill, as proposed by the Treasury, in the original proposal or the revised version, that would deal with this Japanese watch situation that I mentioned?

Secretary DILLON. The deferral elements would remove a certain amount of tax incentive, which I do not think is large in the case of Japan.

Senator CURRIS. But it would not—there is nothing in this bill that would hold, would have held those jobs in the United States, is that true?

Secretary DILLON. I am not sure about those particular jobs because I am not an expert in the watch business. But I know that there are certainly a number of areas where the indications are that there was a choice between manufacturing in the United States and manufacturing abroad. In many cases there is no choice and you have to manufacture abroad. I am not talking about that.

I am talking about where there is a choice.

In those cases sometime tax considerations entered into the picture, and that is what we are trying to remove.

Senator CURRIS. I want to read a hypothetical case to you.

Suppose a U.S. corporation sets up a Swiss corporation to distribute its products, exports, not only to Switzerland but to six countries in the Common Market.

As I understand it, the Swiss subsidiary would pay only relatively small Swiss taxes, 8 to 10 percent, on its income from sales outside Switzerland, and so would ultimately have available for remittance 90 percent of those profits to the U.S. parent.

Section 13 of the bill, however, would immediately tax the U.S. parent corporation on all the profits on sales made outside of Switzerland unless they were invested in a less developed country.

That could be avoided, however, by setting up separate corporations in each of the six countries. In that case, however, each subsidiary would have to pay the relatively high taxes up to 40 or 50 percent imposed by the country in which it is incorporated.

My first question is:

How does it benefit anybody to require seven foreign corporations when one would be more efficient?

Secretary DILLON. We have no intention of requiring seven. One would be more efficient. There is no reason not to continue with the one and just pay the tax. [Laughter.]

Senator CURRIS. But if they had the six, they would avoid the United States tax, would they not?

Secretary DILLON. Well, you said the tax in the other six would be very high, so they would not avoid so much U.S. tax.

Senator CURRIS. All right.

If they can lessen their tax burden in the foreign field, there is more money to remit to the United States, is there not?

Secretary DILLON. As I said, the record shows that for tax-haven countries, the amount returned is 15 percent of profits, which is not very large.

Senator CURRIS. Fifteen percent of more profits is more gain to the country than 15 percent of less profits.

Secretary DILLON. Probably not as much as 52 percent of a somewhat smaller amount.

Senator CURRIS. But none of it was earned in the United States.

Secretary DILLON. What we are trying to do, as I say, is to avoid the overall tax incentive for investment abroad. We are all in favor of foreign investment.

All we are saying is that it should not be built on special tax considerations. This whole business of tax havens is a rather new development.

The great majority of our investments abroad were made over the years and many companies have been abroad for many years. They did not, when they made their investments abroad, make use of tax havens.

Tax havens are a relatively new development, and we think that if business developed earlier without extensive use of tax havens, it will continue to develop and there will continue to be substantial investment abroad.

What we are primarily concerned with is this almost total avoidance of all taxes by operating through an artificial set-up of tax havens.

Senator CURRIS. Now, suppose the bill is enacted as you recommend it.

What will be the relative position between the investor in the United States who invests a given amount of money directly into a foreign corporation, say, the Philips Co., to supply the European and the

world market, compared to the investor in the United States who invests the same amount of money into a U.S. domestic corporation that solely owns a subsidiary which competes in the same territory as the Philips Co.?

Secretary DILLON. I think the tax differences would be very minor, and that no investor would make his decision based on the tax consequences.

Senator CURTIS. Well, now, if someone invests in a foreign corporation, such as Philips Co., he pays no taxes. They do not have their share of the earnings depleted at all, until they actually get their portion of the income in their hands back in this country, is that not true?

Secretary DILLON. They do not—I think that is roughly correct.

But it is also correct that, in general, foreign countries make much less use of tax havens than our business is at present doing. The reason for that is that practically all foreign countries except Germany have a measure of exchange control. They simply do not permit their companies except in exceptional cases to use tax havens.

And, generally, when they do give this permission, part of it is an arrangement that a very substantial part of the profits be remitted their own country. That is the way they control the situation.

It is only in the case of the United States, where the situation is at the moment more or less out of control.

Senator CURTIS. I have a photostatic copy of an ad which appeared on April 27, 1962. I cannot vouch for its accuracy. If it is fraudulent, I would assume that the paper in question did not know it.

It says:

Will pending U.S. tax legislation make your European subsidiary uneconomic? We are interested in studying acquisition of control in going European businesses of all sorts. Send details. Cybel Corp., 20 Rue de la Marche, Geneva, Switzerland.

What would prompt such an ad?

Secretary DILLON. Well, I do not know whether the ad was put in by a company that is an American-controlled Swiss corporation or not.

I would have to know more about it before I could answer, Senator.

Senator CURTIS. Now, I want to ask you some things about withholding.

The withholding provisions in the bill permit persons who expect to owe no tax whatsoever to relieve themselves from withholding by filing exemption certificates on savings accounts, but they cannot file them with the Government on interest-bearing bonds of the United States.

Since many retired people still owe no tax, will this not discriminate against the holders of U.S. bonds?

Secretary DILLON. No. We would, of course, like to have exemption certificates generally, but coupon bonds are often sold in between coupon dates, which means there has to be an allocation of interest, so the exemption certificate procedure was just impractical. This was stated very forcibly by the banks that would have to try to run it.

We thought their reasons were good and did not recommend certificates in such a case.

Now, coupon bonds are not generally owned in any large quantity by people of small means. They have become something which is

owned largely by corporations and insurance companies and pension trusts and people of very much larger means.

The U.S. Government savings bonds are in a special category and, as you know, there is no withholding on that until they are cashed in. And exemption certificates are permitted there.

Senator CURTIS. Exemption certificates will be permitted on what type of bonds?

Secretary DILLON. On E-bonds.

Senator CURTIS. In the absence of an exemption certificate, will the tax be withheld on E-bonds?

Secretary DILLON. That is correct, when they are cashed in.

Senator CURTIS. When they are cashed in.

How will that work?

Secretary DILLON. It will work quite simply. The bank will pay the individual, when he cashes his bonds in, the purchase price of the bonds and 80 percent of the interest that has accrued to him at that time, and will withhold 20 percent of the income.

Senator CURTIS. All right.

Taking the case of the bond purchased for \$75, and when that matured worth \$100, how much will be withheld?

Secretary DILLON. Twenty percent of \$25, or \$5.

Senator CURTIS. And that will be withheld unless a person files an exemption certificate, and who can file an exemption certificate?

Secretary DILLON. Anybody can file an exemption certificate who states that he does not consider that he will owe any tax.

Senator CURTIS. Regardless of his age?

Secretary DILLON. Regardless of his age.

And if he is under 18, he can file an exemption certificate or one can be filed for him irrespective of whether he owes tax or not.

Senator CURTIS. Now, there was some disagreement, as I understood the testimony, concerning applying withholding tax to the business of insurance.

It was not covered specifically in the appearance of the American Bar Association, and I asked a question, but the answer I got was, to my mind—I may be wrong—in conflict with the testimony of the insurance people.

What transactions, what interest transactions in the business of insurance will be subject to the withholding tax?

Secretary DILLON. We suggested that interest payments that are added to dividend accumulations under unmatured policies be covered under withholding.

The insurance industry requested that there be a special exemption for this.

We think this involves about \$100 million where the failure to pay tax is almost 100 percent, and, so, therefore, we feel it is important to have withholding.

The companies said that if, in spite of their hope that this would not be included, it was included, then it was imperative that there be no exemption certificates for this area because the amounts are so small, and we concurred in that. We thought it made no sense, because this extra interest is always left with the company and added to the policy. So we have suggested that there be no exemption certificates in this area in accordance with the recommendation of the industry.

Senator CURTIS. Now, then, the position of the Treasury is that in a participating policy where interest is credited to the policyholder, that withholding be required?

Secretary DILLON. That is correct.

Senator CURTIS. Would that be true regardless of how the interest was applied?

Secretary DILLON. I would assume so.

We are now moving into a technical field where I am not certain, but I am informed by my staff that that would be so regardless of how it was applied.

Senator CURTIS. So the case of an individual buying an insurance policy in a company that writes a policy giving the policyholder participation in the earnings, and if that interest is used either to reduce the amount of the annual premium that he must remit or if it is used to shorten the period over which the premiums must be paid, or if it is used to purchase additional insurance, in all three instances the Government would have to—or the insurance company would withhold 20 percent of the interest?

Secretary DILLON. As to interest, yes. Dividends, which are, in effect, a reduction of premium, are not taxable, and there would obviously be no withholding on them. All we are talking about is the interest on the dividends which are relatively small amounts but which, added up, come to a large amount.

And we do not see any reason why this \$100 million of revenue should go untaxed, and this is an area where we have found that there is almost complete lack of reporting.

It is exactly the same thing as if interest had been credited to an individual with a savings account; that is what this withholding is all about. So that there will be withholding on that.

We think that interest that he receives with respect to his policy should be treated in the same way.

Senator CURTIS. Now, one of the larger insurance companies of the Nation located in my State, which is over 75 years old, it is not one of the top 10, but it is one of the top companies, advised me that the average interest allocation per policy is 70 cents.

Secretary DILLON. That is the reason we felt it was foolish to have exemption certificates. As you know, Senator, there is a great deal of life insurance in effect in the United States, and these 70 cents add up to \$100 million a year on which we lose revenue.

Senator CURTIS. Suppose the policyholder wants to get credit for that 14 cents tax that has already been paid, is he going to be given any certificate by the insurance company showing how much has been withheld and remitted to the Government?

Secretary DILLON. I think ordinarily he is always given by the insurance companies some sort of a statement which indicates how much interest was credited to his accounts.

Senator CURTIS. No, I am talking about a tax form. When they withhold on your wages, they give you a tax form attached to your tax return.

Secretary DILLON. It is not necessary. They merely tell you what has been credited to you, and you know without having any form that there has been a 20 percent withholding. In other words, the amount

withheld is 25 percent of whatever has been credited to you. You know what automatically.

Senator CURTIS. How will the Treasury know when the individual policyholder makes his tax return how much has been withheld in interest on his insurance?

Secretary DILLON. Well, I would assume that when the individual makes his return at the end of each year, the form will have a place, which says interest, and another place where it has the amount that has been withheld, which would be 25 percent of the interest. If the taxpayer wishes, as I think without exception he will, to take advantage of this credit, will fill in that figure and that is how the Treasury will know.

Senator CURTIS. It will mean some additional computations in the handling of that life insurance, won't it, for the company?

Secretary DILLON. Some, but the life insurance companies felt it would be not too difficult as long as they were certain that the regulations were worked out so that the income, the interest, was applied in the same year as it was actually earned, so they did not have complications of computing interest from prior years. I think we will work that out.

That extra computation for the life insurance companies will be very small. It would have been very large if they had had exemption certificates and that is why that would have been impossible.

Senator CURTIS. Isn't it very likely that it will change the type of insurance policies written?

Secretary DILLON. Not in the slightest, I do not think.

Senator CURTIS. Has the Treasury discussed this with the insurance companies?

Secretary DILLON. Yes.

Senator CURTIS. Isn't it true that there will be an inducement for a trend in writing policies to end up with no interest being credited to the policyholder?

Secretary DILLON. I would not think so at all, no.

Senator CURTIS. I am inclined to think that it will.

Secretary DILLON. There is a difference of opinion.

Senator CURTIS. I think that to have a company withhold 14 cents from a citizen—

Secretary DILLON. That he owes.

Senator CURTIS (continuing). Means two or three additional computations every time the premium notice goes out, is going to end up in not only a change in writing new policies, but in an attempt to convert policies.

Secretary DILLON. It will not require all these extra computations. There is one computation that is done once. The interest that will be applied will just be 20 percent less than it would have been otherwise, so there are no more computations than there are presently.

Senator CURTIS. Now, it has been argued that since we have wage withholding we should have interest and dividend withholding. Opponents of withholding here on this committee and elsewhere, use that as one of their principal arguments that the system of interest and dividend withholding now proposed is quite different from the present wage proposal.

Secretary DILLON. The wage withholding can be more onerous on those who are withheld on.

Senator CURTIS. Now, to make the two systems the same, we would require that 20 percent of all wages and salaries be withheld at the source regardless of the number of personal exemptions which the employee has, unless he owes no tax whatsoever. You would not favor that.

Secretary DILLON. I think the wage withholding system we have now is very equitable and works very well. I think that the system we are providing for dividend and interest withholding will work equally well.

There will be a moderate amount of overwithholding on a few people, none of which will be hurt in the slightest by it, and they will get their refunds back very promptly.

I must say that the propaganda that has been put out that this will hurt old people is totally false. There will be not the slightest hardship for anyone, any old person, as a result of this withholding system, and I can prove that with figures.

Senator CURTIS. How can you produce statistics to show that to take some money away from somebody who doesn't owe it and give it back doesn't hurt?

Secretary DILLON. Well, I will give you an example, Senator. It is very simple.

If you take an elderly couple, which is what we are talking about, who are receiving interest and we will take the worst situation we can imagine, so that we will try to see if it can have an effect on them, and we come to this: An elderly couple which receives social security, can have as much as \$5,377 of income without being taxable—\$2,178 of that would be from social security, and \$3,199 would be from interest. So the only people who would be affected would be people with an income of more than \$3,000, roughly \$3,200 from interest income.

To get \$3,200 from interest, this aged couple would have to have bank deposits at an average yield of 4 percent, or \$80,000, so they would not be exactly indigent. If they were going to have overwithholding they would have to have some more income. Let's assume that they have \$1,000 more income. Well, then their bank deposit would be roughly \$105,000. In that case, they would have been receiving \$4,200 a year in interest income, and they would have withheld on that about \$210 a quarter, of which \$160 would be overwithholding, and so, therefore, the first quarter that that happened, they would have to forgo \$160.

Now, every quarter thereafter, the refund would come in in time to take care of the overwithholding, so this would be a one-time effect. All they would have to do would be to take \$160 out of their \$105,000 of savings, and loan it to the Government and I do not call that a hardship. [Laughter.]

Senator CURTIS. Well, your hypothetical case is very interesting but it does not describe anybody living in Nebraska.

Secretary DILLON. It certainly does, every old individual—I would like to see any other example that is different.

Senator CURTIS. There is nobody who gets social security like that.

Secretary DILLON. If you do not get social security the example is even better. I would be delighted to give you that example. The couple would have to have \$150,000 instead of \$105,000.



Senator CURTIS. Are you advocating an exemption certificate for dividends?

Secretary DILLON. An exemption certificate for dividends?

Senator CURTIS. In connection with dividends.

Secretary DILLON. Yes, sir.

Senator CURTIS. There would be no withholding on dividends.

Secretary DILLON. For people who have the right to exemption certificates.

Senator CURTIS. Is that a departure from the original proposal?

Secretary DILLON. No, that was in the House bill.

Senator CURTIS. It was not in the original Treasury proposal, was it?

Secretary DILLON. No, it was not in the original Treasury proposal. For the reasons which we have described, we did not feel that this overwithholding would be a real hardship and, therefore, we thought the whole thing could be accomplished by these rapid refunds with much less work on the part of the payors. As a result of a great deal of propaganda, many citizens felt they would be harmed by this situation, so the decision was reached, and I think it was a fair and good decision, to include exemption certificates for those who do not owe tax. I think that is an improvement, but it has resulted in some more work for the payors.

Senator CURTIS. Now, is it your present proposal that a shareholder of any age can obtain an exemption certificate in reference to dividends?

Secretary DILLON. Yes, if he is entitled to it.

Senator CURTIS. Who would be entitled to it?

Secretary DILLON. Anyone who considers that he will not have to pay any tax. Of course, when you get to dividends, under the present law, with the dividend exclusion, and credit the amount of income you can receive before you are taxable is higher, so your capital would be still larger than the figures I mentioned earlier.

Senator CURTIS. But the fact remains that if the individual was a widow lady, 55, not drawing social security, and not entitled to a double deduction, but the amount of her money that the Government would use throughout the year, the amount that she would have to make application for refund for would be a greater amount, would it not?

Secretary DILLON. Somewhat greater. We can give you tables on every age, and possible type of situation. But the general principle is that the overwithholding can only affect one quarter, the first quarter, because it is always made up thereafter. Whenever there is overwithholding there has to be a substantial amount of other income, which means there has to be a substantial amount of capital available.

Senator CURTIS. Who can file an exemption certificate besides the individual who is willing to state under oath that he will owe no tax?

Secretary DILLON. Exemption certificates are also provided for non-taxable organizations such as —

Senator CURTIS. No, I am talking about individuals.

Secretary DILLON. All children under 18, irrespective of whether they owe taxes or not.

Senator CURTIS. But adults cannot file an exemption certificate if they have reason to believe they will end up owing some tax, even though the amount withheld is way more than they will owe.

Secretary DILLON. That is right.

Senator CURTIS. So as far as adults are concerned, the only way they can obtain the certificate is to state they will owe no tax.

Secretary DILLON. Otherwise they are subject to the refund procedure which has worked so well in wage and salary withholding where we refund 37 million checks a year, with no complaints and in amounts that are far larger on the average than will be the case for any over-withholding under this interest and dividend proposal.

Senator CURTIS. But with respect to wages, they do get to show a personal exemption, do they not?

Secretary DILLON. That is correct, but they do also end up with a refund for overwithholding.

Now, the average refund in wage and salary cases is about \$150 and that is held for a whole year. The refunds that will be due under dividends and interest withholding will be more in the nature of \$10 or \$15 and they can be gotten quarterly, so there is no just no comparison. There is just no case that will be any hardship to anybody.

Senator CURTIS. I did not expect to resume question 8 or think I will, in reference to the income earned abroad, but there was one question I forgot.

Secretary DILLON. Yes.

Senator CURTIS. And that is this: How much revenue would have been obtained, additional revenue, would have been obtained on income earned abroad under the bill as it passed the House annually?

Secretary DILLON. I am just getting that figure because it slipped my mind, Senator.

Senator CURTIS. Then I want—I will wait.

Secretary DILLON. Of course, these figures were all in my original statement. As it passed the House, the item on controlled foreign corporations we estimated would have brought in \$85 million.

Senator CURTIS. How much?

Secretary DILLON. \$85 million.

Senator CURTIS. How much income will be obtained if the bill is enacted, with the modifications which you recommended yesterday?

Secretary DILLON. We had not figured that out. If we have complete elimination of deferral, the figure was \$230 million. I am not sure what the figure is with the changes that we recommended yesterday if you do not eliminate deferral, but my guess is it would be somewhere around \$125 million.

Senator CURTIS. Do I understand you correctly under the House bill?

Secretary DILLON. \$85 million.

Senator CURTIS. \$85 million additional revenue annually for the U.S. Government.

Secretary DILLON. That is right.

Senator CURTIS. Under your recommendations of yesterday, \$120 million.

Secretary DILLON. Under our recommendations yesterday our basic position is unchanged. We felt the simplest way to do it is to elim-

inate deferral entirely; then the additional revenue is 230 million annually. But under our alternate recommendations if we cover only tax havens as under the House bill my guess is that it would be about \$120 million, but it may even be less than that. The basic change that we are recommending for tax havens from the House bill is the elimination of the privilege of avoiding tax by investing profits from European tax havens in Latin America. I think some \$25 million is involved there. Beyond that I think the differences are nil. The types of things we were trying to do yesterday were not meant to involve revenue. They were meant for simplification and making it easier to do business abroad, and for correcting certain inadvertent errors in the drafting of section 13, which was drafted very rapidly at the end of the consideration in the Ways and Means Committee and did not have the same long and thorough consideration as the other sections of the bill.

Senator CURTIS. Now, I am a little bit puzzled. I thought yesterday that the Treasury was advocating modifications favorable to concerns doing business abroad.

Secretary DILLON. We were.

Senator CURTIS. It is going to collect \$35 million more.

Secretary DILLON. That was recommended originally on April 2. That same recommendation was made then. So yesterday's modifications, with one exception, would all act favorably to business. The one exception is that we feel tax haven earnings from service contracts and things of that nature should be included in the bill. But we would have to make—and I would be glad to do it, because it is appropriate—a new estimate, if you would like to have it, based on what a tax haven bill would bring in, based on our latest recommendations.

Senator CURTIS. Well, the bill we had before us yesterday was the House bill.

Secretary DILLON. That is right.

Senator CURTIS. And I left the room under the impression, after reading your speech and listening to it, that certain concessions were made to businesses.

Secretary DILLON. That is correct.

Senator CURTIS. But instead of collecting \$85 million from them, you are going to collect \$120 million annually.

Secretary DILLON. Well, I think one of the things that you have got to bear in mind is that the original estimate was made on the basis of what we had intended the House bill to do. Testimony then brought out certain things in the bill which probably went beyond what was really intended. They might have yielded more revenue, but we had not thought of them and had not had them in the revenue estimate.

Those are the types of things that we recommended modifying yesterday.

In addition, we did recommend, when we came up originally, and we renewed the recommendation yesterday, that this one item of spillover of investment of profits from developed to underdeveloped countries be eliminated and that was no change yesterday from earlier testimony. But it was a change from the House bill.

Now, the testimony yesterday did suggest modifications in the House bill, practically all of which were in the direction of simplifying the impact. These changes would not have great revenue impact, however.

For instance, the modification of section 16, which as presently drawn, would have taxed at ordinary income any profits made since 1913 by a company that was liquidated. We thought that was too sweeping and certainly should not be in the bill. We recommended that the date be set at next December 31. But I do not think there was ever any estimate for revenue from that in the House bill, and in the estimate we submitted to you.

So there was very substantial modification that had no revenue effect.

Senator CURTIS. Just what was it in your recommendations yesterday of changes in the bill which was before the House that increased it from \$85 million to \$120 million?

Secretary DILLON. Nothing.

Senator CURTIS. Nothing?

Secretary DILLON. The only thing that might increase this slightly was the inclusion as tax haven income, of income from service companies that operated out of tax havens, that was all.

Senator MORTON. Will the Senator yield?

Senator CURTIS. Yes.

Senator MORTON. As I understand it, Mr. Secretary, the \$85 million was not responsive to what you later discovered after careful study but was the application of section 13 as prepared in the Ways and Means Committee.

Secretary DILLON. That is correct. The figure should be about \$95 million instead of \$85 million. Under my original recommendations of April 2, if you adopt the elimination of deferral, the figure of \$230 million stands.

If you adopt the approach of the House bill—which would yield \$95 million, my recommendations of April 2 would have increased that \$95 million to about \$120 million, largely or almost entirely owing to the removal of the privilege of reinvesting tax haven profits in underdeveloped countries.

Any changes that were made or suggested yesterday would reduce those figures of \$230 million and \$95 million, both of them, somewhat.

We haven't figured out by how much they would reduce them, but the net effect of the changes yesterday would result in some reduction.

Senator CURTIS. The net effect of the changes yesterday would be to put a greater emphasis on a determination of what was a developed or underdeveloped country, is that not it?

Secretary DILLON. No. That has not changed. That emphasis is the same. There had been an exception in the House bill whereby tax haven profits earned in Europe could avoid taxation, if they were reinvested in underdeveloped countries, and we recommended them when we first appeared here, that that particular exception be repealed.

As I pointed out earlier, we said there should be complete freedom in the handling of manufacturing businesses in underdeveloped countries, but the relaxation did not go quite that far.

So to that extent my recommendation yesterday may have favored the underdeveloped countries a little more.

Senator CURTIS. Now getting back to withholding: How would your example work in the case of a disabled single person under the age of 65 receiving \$1,500 a year of dividend income?

Secretary DILLON. And what other income?

Senator CURTIS. That is all.

Secretary DILLON. No pension, no nothing?

Senator CURTIS. Under 65. He is disabled, he is living on \$1,500, on dividend income.

Secretary DILLON. We will be glad to work that one out, and show you how that would operate. But if he is living on \$1,500 of dividend income, he certainly has a total of probably about \$50,000 in securities because the average yield on dividends is 3 percent now.

Senator CURTIS. I understand that but I am talking about a disabled person who is living on \$1,500 dividend income.

Secretary DILLON. Well, the maximum withholding on this is \$300, so that the maximum withholding that could be made in any one quarter is \$75. So for him to get caught up he would have to take \$75 out of his \$50,000 capital, so I still do not see how he is greatly damaged.

Senator CURTIS. The country would have \$75 of his money continually without paying interest.

Secretary DILLON. It would have \$75 until such time as he reached a situation where he owed no tax, and as soon as he reached that time he would get his \$75 back.

Senator CURTIS. But he can file no exemption until and unless he can truthfully say that he expected to owe no tax.

Secretary DILLON. That is right.

Senator CURTIS. But his—

Secretary DILLON. Again it is just no hardship.

Senator CURTIS. But his periodic income would be reduced by 20 percent.

Secretary DILLON. That statement is exactly what is wrong, and that is where the propaganda has been so false on this.

Senator CURTIS. How much are you going to withhold?

Secretary DILLON. It is incredible.

We will withhold \$75, but he will get a quarterly refund of the full amount of any overwithholding, so there will be no reduction in his income except in the first quarter, and it is absolutely inaccurate to say that his periodic income will be reduced because it will not be.

Senator CURTIS. As soon as he goes down to make his application for a refund and gets it back, it will take another \$75 from him.

Secretary DILLON. His refund will offset another overwithholding, so his income will be just the same as it was before.

Senator CURTIS. So you are suggesting that he take \$75 out of his capital.

Secretary DILLON. I am suggesting that he can either borrow it or take \$75 out of \$50,000 capital, and I am saying that is not a major hardship to this individual. Certainly I just cannot see where taking \$50 or \$75 out of \$50,000 is going to be a great hardship to anybody.

(The hypothetical case referred to follows:)

Single person under 65, disabled, living on dividend income of \$1,500 annually. He must own approximately \$50,000 of stocks to earn that income at an average yield of 3 percent per annum.

Tax computation:	
Dividend income.....	\$1,500
Less:	
Exclusion.....	—50
Exemption.....	—000
Standard deduction.....	—145
	705
Taxable income.....	705
Tax liability at 20 percent.....	141
Less: dividend credit.....	—28
	113
Withholding computation:	
Withholding annually, 20 percent of \$1,500.....	300
Less: tax after credit.....	—113
	187
Overwithholding.....	187
Overwithholding per quarter.....	47

Senator CURRIS. We could probably propose a capital levy, or it could be argued that would not be a hardship on anybody.

Do you favor a capital levy?

Secretary DILLON. No. Nobody has said anything about a capital levy.

Senator CURRIS. You suggested that he take \$75 out of his capital and give it to the Government.

Secretary DILLON. I suggested that is one way he could do it.

Another way he could do it is go down to the bank and borrow it. If he did that it would cost him about \$4 a year in interest—that would not be very difficult.

Senator CURRIS. To give to the Government something which he didn't owe.

How could he reduce his withholding because of the exclusion of the 4 percent dividends credit?

Secretary DILLON. How could he what?

Senator CURRIS. Reduce the amount withheld by reason of the \$50 exclusion or the 4 percent credit?

Secretary DILLON. He would get a larger refund then.

Senator CURRIS. Yes.

But he couldn't reduce the impact on his withholding.

Secretary Dillon. No.

Senator CURRIS. Now, in your revenue estimate for withholding, you indicate that \$180 million of the \$650 million will come from better reporting above the 20 percent bracket.

With a withholding system which provides no receipts whatsoever for the dividend, what reason do you have for assuming that you will realize any of this additional \$180 million from the withholding system?

Secretary DILLON. Because it is very clear that the individual will have to list his full dividend income to get credit on his tax for withholding.

Now, the only way that he would avoid that is by straight fraud, by listing wrong figures on the tax return, and experience has shown that there are not too many people, although there are some, who are inclined to do that.

There are many more that are inclined just to forget something. But with the need of listing the withholding so as to get credit for it, we think that we would undoubtedly pick up this extra amount.

Senator CURTIS. You have used some figures of some sizable amounts of investment in order to produce a given amount of dividend income used in these hypothetical cases.

You have further stated that there was something on the tax return to call their attention to these transactions, and they are likely to report it anyway.

Now, with someone who has fifty or a hundred thousand dollars in stocks, he is ultimately going to buy and sell some stocks, isn't he, and isn't that going to show on his tax return?

Secretary DILLON. I am not sure whether they would buy and sell them or not. I mean, older people, with savings. Probably if they had something like American Telephone stock they would be apt to keep it, not trade it.

Senator CURTIS. How many shareholders will be affected by withholding on dividends who may owe tax but owe no tax on their dividend income?

Secretary DILLON. I don't quite understand what your question is.

You mean you would allocate their tax against the wages and not against the dividends, or allocate that against the rest and not—

Senator CURTIS. We do that now.

The man has wages of \$50,000 a year, he saves a little money and he gets \$95 in dividend income, which represents a nest egg for him that is sizable, but that \$95 is not subject to any Federal income tax.

Now, my question is how many people will have withholding taxes applied to their dividend income who will owe no tax on their dividend income even though they may owe tax on other items.

Secretary DILLON. I think it will be very, small. We will have to answer that question for you for the record because—it would be an infinitesimal number compared to the people—

Senator CURTIS. There are a lot of people who own just a few shares.

Secretary DILLON. That's correct.

But we know the total number of people who will be subject to any overwithholding, and it is not large, so this must be a small fraction of that. So it is going to be a small figure. We will be glad to put it in the record.

(The computations referred to follow:)

Withholding would not create hardship for taxable individuals who receive dividends that are completely excluded under the \$50 exclusion. First, there are relatively few individuals of this type. Secondly, the maximum overwithholding on a single person would be only \$10 and on a married couple filing jointly—only \$20. Other taxes due from these persons, however, are normally in excess of \$20 so that there would be little, if any, net overwithholding due to the operation of the dividend exclusion. Shown below are the number of taxable returns reporting dividends that are completely excluded. It should be noted that a large proportion of these returns have incomes above \$5,000, which presumably would have substantial estimated tax to offset any withholding on dividends.

Adjusted gross income:	Number of returns
Under \$5,000.....	150,000
\$5,000 under \$10,000.....	470,000
\$10,000 and over.....	340,000
Total .....	960,000

Source: "Statistics of Income for Individuals, 1959."

Senator CURTIS. What would be the average investment, just a rough estimate, that would require the production of \$95 of dividend income for a couple of any age?

Secretary DILLON. About \$3,000.

Senator CURTIS. How many shareholders do we have in the country who own less than \$3,000 in stocks.

Secretary DILLON. I think there are probably numerous people that do but the same people also have deposits in savings and loan institutions and in savings banks, and savings deposits in other banks, and they may own mortgages and other things, and will have wages or salaries or other such income.

I think there are probably very few that have nothing but the stocks.

Senator CURTIS. A good many employees are buying stock in small amounts and they accumulate a thousand or two or three thousand dollars, do they not?

Secretary DILLON. Actually the effect of all this, is that you are talking about someone who has wage and salary income.

Now, the average overwithholding on wages is \$150 a year, and in effect all that will happen here is that the amount of tax or refund that is finally due at the end of the year will be somewhat modified.

Senator CURTIS. Now, the debates in the House indicate that some 8 million persons would be eligible to file exemption certificates.

Some will file them and some will forget. Some will file them with certain payors and not with others.

Since no withholding statement like Form 2 for wage earners will be given to these persons, how will they know a year later when they make out their tax returns which items were withheld on and which were not?

How will the Internal Revenue Service be able to check their refund claim for accuracy?

Secretary DILLON. You mean these people who have filed exemption certificates?

Senator CURTIS. Yes, or forgotten to, or filed it in some cases and not in others.

Secretary DILLON. I think that would be up to them. We would assume that if they had filed an exemption certificate they would know where they had filed it, and where they had not.

If you have a person who has a very large number of exemption certificates to file, I begin to doubt that he will be eligible because of the amount of his income.

But the ordinary person with an exemption certificate doesn't have so many places to file, because he doesn't have so many sources of dividend or interest income.

Maybe a few complications may arise where the Internal Revenue Service will lose a little money that they might otherwise have gotten. But the net result is we get \$650 million. This is a small part of the reason why we will not get the full \$800 million but only \$650 million.

Senator CURTIS. What is the status of Puerto Rico; is it a territory or a commonwealth?

Secretary DILLON. It is the Commonwealth of Puerto Rico.

Senator CURTIS. And what is the tax status at the present time of a subsidiary operating in Puerto Rico wholly owned by a U.S. corporation.



Secretary DILLON. As I understand the tax status, it is similar to a foreign corporation, because we have a special arrangement with Puerto Rico whereby they collect their own taxes and do not remit them to the United States but use them in Puerto Rico to help in the development of the island.

Senator CURTIS. What will be their status if your recommendations for taxation of foreign income in this pending legislation are carried out?

Secretary DILLON. They would, in effect, be unchanged.

Senator CURTIS. Unchanged?

Secretary DILLON. Yes.

Senator CURTIS. That's something carried in yesterday's recommendations.

Secretary DILLON. That is right.

Senator CURTIS. There are some things in the bill that are a bit unclear.

The proposal refers to income from the U.S. patents, copyrights, and exclusive formulas and processes. There would seem to be innumerable questions concerning the exact scope and effect of this language.

For example, what is the intended scope of the term "exclusive formulas and processes."

Would this include company engineering or technical service assistance?

Secretary DILLON. At the moment, I don't think it does. There were recommendations yesterday in my statement that this is simplified by collecting it at the time of sale of the patent instead of having to figure out the income from the patent every year. That would be very complex. There were some technical objections brought out to that in the testimony here which we thought were valid, so we adopted this change.

Senator CURTIS. Would the term "exclusive processes" include administrative or mostly assistance?

Would it include a particular accounting system?

Secretary DILLON. If you have some particular detailed questions, I would be glad to try to answer them in writing to be sure we are accurate.

Senator CURTIS. Well, these could be submitted later.

Secretary DILLON. I think that most of this problem will disappear under the change we suggested, but I would be glad to answer your questions. I want to be sure I answer them accurately, so if you would submit them we would answer them.

(Copies of Senator Curtis' questions and the Secretary's replies were not submitted for the record.)

Senator CURTIS. That leads me to the hope—I realize it will take some time—that the Treasury's proposal as of yesterday can be reduced in complete bill form so that we might have the benefit of any information and testimony pertinent to it.

As one member of this committee, I have found this bill very difficult because of the fact we are dealing with so many subjects.

Two or three years ago the tax on life insurance was undertaken by this committee and we had nothing before us but life insurance and it was a difficult job, assuming our considering mutual and stock insurance companies.

Well, the tax on life insurance in this bill is just one small part of the bill, and I have moved as fast as I can and tried to keep up with it and I am still way behind.

Has the Treasury had a chance to examine the recommendations made with respect to the taxation of mutual, fire, and casualty insurance companies, the testimony here in the Senate concerning the House bill?

Secretary DILLON. Yes, we have.

Senator CURRIS. They recommended about five changes.

In general, what is your position on that? I don't believe that was covered in your statement yesterday.

Secretary DILLON. No, because in general, we didn't feel that any major change in that area was required, in addition to the changes that we had suggested on April 2.

The only type of changes that might be needed would be extremely technical things such as are always worked out in executive session.

Senator CURRIS. Now, these small neighborhood mutual insurance companies under the present statute are exempt from taxation if their premium income is less than, what is it, \$75,000?

Secretary DILLON. I think it is something like that.

Now, there is a special provision for small companies in the current bill. Again these—the way this operates is not a major matter of substance as far as we are concerned.

It may be that the committee would decide that they should be somewhat more generous in this cutoff or somewhat less generous, and either way would, we feel, not make any great difference in policy.

Senator CURRIS. Well, I wonder if your staff could advise me if I am correct in the \$75,000 figure, and when was that established?

Secretary DILLON. The present law, I understand, is \$75,000.

Senator CURRIS. It goes back to about 1918, doesn't it?

Secretary DILLON. That I do not know, and my staff doesn't know, but we will be able to look that up.

(The information referred to follows:)

The \$75,000 exemption level was established in 1942.

Senator CURRIS. It goes back many years.

Would you be opposed to bringing that figure up to the comparable value of the dollar?

Secretary DILLON. As I said we have no deep or strong feeling about where you give relief to the very small companies, or where you set that figure. These changes we are suggesting are not meant to be injurious to these very small companies to which you are referring.

They were meant to apply to medium-sized and larger companies in the business which we feel had paid too little tax in the past.

Senator CURRIS. It just seems to me that these little neighborhood companies with no salaried officers whatever, and back many years ago they didn't have to pay any tax if they had \$75,000 gross receipts, they ought to be at least doubled, and their witnesses all support this. I was hoping that you would endorse that proposal.

Secretary DILLON. All I am saying here is this is in an area that is so technical that I would prefer not to endorse one particular figure, but I do endorse the general view that there should be liberalization. The Treasury agreed with the liberalization in the House bill for these small companies.

Senator CURTIS. The mutual insurance companies have also asked as a substitute for access to the equity capital market, a protection against loss account to be allowed without restriction, insisting on 1 percent of incurred losses plus one-fourth of underwriting gains.

As I understand the House bill there is a restriction in the bill that, after it is in this account for, I guess it is 5 years, it goes out. They wanted to build up this account without restriction.

What is the position of the Treasury on that?

Secretary DILLON. We felt that this was unnecessary.

Actually this is a very localized and special argument. The provisions in the House bill regarding the protection against loss accounts are of particular interest to only two or three very large mutual companies. We do feel that they are in a position to pay more taxes.

In particular, the provision of the House bill we feel should not be included is the one where, in effect, one-eighth of underwriting profits escapes tax forever.

We think that is particularly unnecessary.

Senator CURTIS. Well, I share the same feeling here as I did in the life insurance tax, that it should be equalized between the stocks and the mutuels. I think we do have a problem in the very small mutuels which clearly are not disguising any profit because they have no paid officers.

Secretary DILLON. Right.

Senator CURTIS. And then we have some others, and personally, I would like to see, in this attempt to equalize the burden between these classes of companies, I would like to see both the small stocks and the small mutuels, say those who have gross premiums of less than \$5 million, have some little break over the giants.

The giants, whether they be stock or mutual, can engage in nationwide advertising, they can do some other things, and the existence and growth of these other companies have definitely been in the public good.

As I said a bit ago, this bill deals with so many things, I assume then what you prefer is not to make any specific recommendations on changes on the tax on mutual, fire, and casualty at this time.

Secretary DILLON. That is correct.

And we indicate that as we were in the House, we are sympathetic to these very small companies just as you mentioned.

Senator ANDERSON. But you wouldn't regard \$5 million as necessarily a small company?

Secretary DILLON. No.

Senator ANDERSON. I would hope not.

Senator CURTIS. May I say to my distinguished friend from New Mexico, I certainly am not suggesting an exemption from taxation. I am suggesting that this \$75,000 be increased to maybe \$150,000.

Then I believe that as an intermediate step that we should give both stocks and mutuels that are small, relatively small, in the field atmosphere where the burden would be equalized, probably increase the revenue at the present time but still give them an opportunity to grow.

Now, Mr. Secretary, as you know there are many ships sailing under a so-called flag of necessity; that is, they are owned by a foreign corporation all of the shareholders of which are American citizens.

Many of these ships are considered in the so-called emergency reserve fleet. The United States has an agreement with the present owners to be able to obtain these ships in time of war. It has been alleged that if this bill is passed, these ships will be sold to foreigners. The United States will, therefore, lose the use of this emergency fleet.

What is your opinion in this matter?

Secretary DILLON. It was not our intention that the House bill should cover this area. Yesterday I pointed out that provision would have to be made to take care of this situation.

The real problem is that practically all of these ships have been financed very heavily by American insurance companies and banks, and the repayments on these debts could not be made if the earnings were subject to tax. To get the repayments they have to go through without tax which is generally the case in Liberia or Panama, and we have no wish to upset this arrangement or the shipping business.

Senator CURTIS. Is it clear they are not covered in the bill?

Secretary DILLON. No. It is clear in the recommendation I made yesterday that we clarify it so that they will not be.

Senator CURTIS. Have you—I assume you have consulted with the Department of Defense?

Secretary DILLON. Oh, yes. We have consulted with the Department of Defense and—

Senator CURTIS. What about the provision for liquidations as they relate to ownership of ships?

Secretary DILLON. Of course that was one of the inadvertencies in the last-minute drafting. It was not a suggestion of the Treasury, and I think as a result of the suggestion I made yesterday, this would be greatly alleviated. However, the tax as to future earnings, if our recommendations are adopted, would be, as to individuals liquidating a shipping corporation, something like 64 percent instead of 91 under the House bill.

Senator CURTIS. Now going to another subject, Mr. Secretary: the Treasury has estimated that under the House bill there would be a revenue increase of \$125 million by reason of disallowance of deduction for entertainment expenses. How much of this estimated increase will be offset by a loss of business in the entertainment industry?

Secretary DILLON. I think practically none, because we feel that the loss of business in the entertainment field will be very little.

For instance, there was testimony before the House which was very interesting, on the matter of the theater in New York. This was by an eminent accountant, Mr. Seidman, who is also by avocation an angel for theater productions. He thought this would be a wonderful bill because it would allow ordinary New Yorkers to buy tickets, which they never had been able to and they could go to the theater. The tickets would not all be bought for the use of out-of-town businessmen on expense accounts. There would be no effect whatsoever on the theaters.

So we think that, with the exception of maybe a few individual places, there would be very little economic impact here, and that overall there would be no loss of revenue to offset against this \$125 million at all.

Senator DOUGLAS. Would the Senator from Nebraska yield to me so I might address a comment to the acting chairman?

Senator CURRIS. Right.

Senator DOUGLAS. Mr. Chairman.

Senator GORE. Acting chairman.

Senator DOUGLAS. I have been informed the Senator from Nebraska has been questioning the Secretary of the Treasury since 10 o'clock this morning; it is now 20 minutes after 12 by the clock, and the chairman said the hearing will close at 12:30. I see he is being furnished questions by members of the staff. I wondered, therefore, if we could not ask him to impose upon himself a 2-hour-and-20-minute rule so as to permit other members of the committee to ask questions.

The whole thing, Mr. Chairman, seems to me to be a filibuster designed to prevent the Committee from proceeding to the consideration of the bill, to prolong the hearings, to tire out the Secretary, and to impede the progress of the legislation.

We believe in full and free discussion, but I think also that other members of the committee should be privileged to ask questions. I submit that, the record to date, while perhaps it has been technical, is highly negative. I would like to have now I think 9 minutes to ask questions of the Secretary.

Senator CURRIS. Mr. Chairman, may I make a response to that. The staff has prepared questions for me, but no questions have been prepared unless I have asked for them. I have stated repeatedly this is a complex bill, 240 pages, I think one of the most brilliant committees in this Congress worked a year on it. If the Senator from Illinois can point to one frivolous question that I have asked, not related to this bill or to basic revenue policies, I shall here and now ask unanimous consent that it be stricken from the record.

Senator ANDERSON. Could I just volunteer the question you asked him about whether Puerto Rico was a commonwealth or a territory did not have too much to do with the question of taxation?

Senator CURRIS. It did. It was submitted to me by a resident of Nebraska who has an operation in Puerto Rico. It was submitted before his statement of yesterday, and at the present time——

Senator ANDERSON. The Senator from Nebraska knew.

Senator CURRIS. A subsidiary in Puerto Rico at the present time is treated as a foreign corporation.

Senator ANDERSON. I am not arguing that but I only say the Senator from Nebraska knew the answer to the question before he asked it; why ask it?

Senator CURRIS. That was a preliminary question to ascertain the meaning of his statement of yesterday because, as I understood it, the colloquy yesterday, he talked about territories. But, Mr. Chairman, I ask unanimous consent that the question I asked as to whether or not Puerto Rico is a commonwealth or a territory and the answer thereto be stricken from the record.

Senator GORE. Is there objection?

Senator ANDERSON. We made that much headway. [Laughter.]

Senator GORE. The Chair hears none and the question will be stricken.

Shall the Secretary's answer be stricken? Without objection, the Secretary's response will be stricken, too.

Does the Senator from Nebraska yield?

Senator ANDERSON. I would just say for the Senator from Illinois that Senator Morton came by and indicated that his testimony would take less than 30 minutes. I understand Senator Williams, whom we all respect, and who does have a great knowledge of this field, felt he could finish his questions in about 20 minutes this afternoon. Maybe if the Senator from Nebraska would agree to stop whenever he finishes this morning, whatever it may be, there might be a chance for the Senator from Illinois.

Senator DOUGLAS. I will not take more than 15 minutes.

Senator CURTIS. I will give you 15 minutes right now.

Senator McCARTHY. I think there is a policy question involved here.

Senator GORE. Permit the acting chairman to say that the chairman of this committee is unavoidably detained and he has asked me to preside for him. The chairman had been proceeding upon a theory, may I say to the senior Senator from Illinois, that those who had not had an opportunity to question the Secretary, would be recognized first. There is only one other on the minority side, Senator Morton, and also, according to the list of the chairman has given me, Senator Talmadge, Senator McCarthy, Senator Hartke and Senator Fulbright have not had an opportunity to ask questions. I think Senator Douglas has interrogated the Secretary.

Senator DOUGLAS. I intruded on the time of the Senator from New Mexico.

Senator ANDERSON. For about 2 minutes.

Senator GORE. I am only reading from the list as Senator Byrd marked it for me.

Senator DOUGLAS. I was not recognized in my own right but intruded.

Senator GORE. I am sure Senator Byrd would fully expect the Senator to be recognized in his own right.

Senator DOUGLAS. Mr. Chairman, I think there is a very serious question of policy here and there is a time problem. The Secretary of the Treasury is under tremendous pressure. He has a conference in Rome. We are under tremendous pressure. If we spin out this interrogation interminably, and say that we cannot complete his testimony until after the Rome conference is over, there will be another 11 days before we begin to act. No one knows what is going to happen in that period of time. This will delay the consideration of the bill. We are the bottleneck through which this and other important legislation is pouring and I beseech the members of the minority to cease these filibustering tactics and to get on with the consideration of the bill. I want also to point out that the Secretary will be with us in executive session for detailed questions, and his experts will be here, if he cannot testify, and some of his associates can appear. I think this has gone on long enough.

Senator GORE. Well, the Chair would much prefer that this question be handled by the chairman of the committee.

Senator ANDERSON. Would the chairman feel like asking how many people would agree to limit themselves to 30 minutes this afternoon; I can speak for Senator Morton because he volunteered.

Senator CURTIS. Has Senator Carlson questioned the Secretary.

Senator GORE. He is not here.

Secretary DILLON. Yes, he has; he questioned me the first day.

Senator CURTIS. May I inquire, was it the intention of Chairman Byrd to limit the further questioning to those who had not asked any questions or to give priority to them?

Senator GORE. To give priority.

Senator CURTIS. Because I haven't seen Senator Bennett this morning, my recollection is that he yielded the floor to someone with the implied request to resume.

Senator ANDERSON. I think not. I think I followed him and he quit.

Senator CURTIS. Well, the record will speak for itself.

Senator GORE. The Chairman asked me to preside until noon, which I was glad to do. Matters of procedures are something which I would much prefer, if my colleagues will be agreeable to it, to refer to him. If the Senator wishes to proceed, he is recognized.

Senator CURTIS. Well, I will yield to the imposed gag of the distinguished Senator from Illinois.

Senator DOUGLAS. I did not understand. [Laughter.]

Senator CURTIS. I would suggest that we could save time by not reading the bill at all. I totally disagree with such a procedure. I do have one more question, Mr. Secretary.

Senator ANDERSON. I did not hear anybody propose a gag.

Senator DOUGLAS. I simply suggested restraint; not a gag, but restraint.

Senator McCARTHY. I would suggest—

Senator CURTIS. The Senator has paid no attention to the proceedings this morning.

Senator DOUGLAS. I was with another committee over which I presided.

Senator CURTIS. He came from outside and objected to the questioning by the Senator from Nebraska, and I resented it. You did not hear any of them. You have no right to challenge any of them.

Senator GORE. The Senator from Nebraska is recognized.

Senator CURTIS. When will the new draft of the bill probably be available?

Secretary DILLON. We would have a draft incorporating our changes ready as soon as the committee is prepared to consider them in executive session, which I understand will be after the staff has had a week to prepare the memorandum which the Chairman mentioned yesterday, which will be on the 21st and 22d.

Senator CURTIS. My response is this: I would much rather be able to get the reaction of the people I represent before we go into executive session. Executive session is not the place to present new and additional views, and it would be my hope that it would be available, at least for a few days. I suppose I am wrong, but I assumed that taxpayers have some rights in the legislative process and I hope—I am not scolding the Secretary—I would have hoped that the proposal the committee is asked to vote upon in executive session will be available a few days before we go into executive session.

Secretary DILLON. May I comment on one thing, Senator? I think that the area of the greatest prospective controversy, because of the lack of opportunity really to consider the draft at length in the House, is the foreign area. Those will probably not be the first sections taken

up in executive session, and there certainly will be plenty of time to consider them and to do what you feel is necessary with any of your constituents or interested parties.

All of the changes, however, that we have suggested, have been not *de novo* changes, but changes that are responsive, at least in some measure, to objections that have been raised in the hearings. So there would be really nothing completely new in this in the drafts that we propose.

They will presumably be somewhat more acceptable to those who have objected earlier, because we have taken some of their objections into account.

Senator CURTIS. Mr. Chairman, I will waive my right to further question. I will pass up the questions I have. I will let the record speak forth as to whether or not the inquiries that I have made have contributed to the thinking upon this very complex bill, and I want to again say that I resent another Senator, not even present in the room, questioning my right to solicit information concerning pending legislation; that is all, Mr. Chairman.

Senator McCARTHY. Mr. Chairman, could I say a word on this? I think it was clearly understood yesterday that when the Secretary agreed to come back up that he would be here for only 1 day. Now the Senator from Nebraska talks about the gag rule, he has been asking questions for 2½ hours, so he has taken half the time, and this means he has gagged everybody else who is sitting here. If we are going to adopt a rule, perhaps we should say anytime we have hearings the Senator from Nebraska can have half the time and divide the rest of it with the other members of the committee.

Senator CURTIS. I resent that.

Senator GORE. The committee stands in adjournment until——

[Laughter.]

Senator DOUGLAS. Mr. Chairman.

Senator CURTIS. I do not understand why the proponents of this bill do not want any questions asked about it. And that is something they will have to explain to the American taxpayers.

Senator McCARTHY. It is just that we do not want you to ask all of them.

Senator CURTIS. I haven't; I haven't asked any until today, and I quit as soon as the schoolmaster suggested I do so.

Senator GORE. The Chair recognizes the Senator from Illinois for a comment only.

Senator DOUGLAS. Mr. Secretary, would your staff be willing to meet with the staff of the Joint Committee on Internal Revenue Taxation and the legislative counsel of the Senate during these coming days to perfect the technical aspects of the bill?

Secretary DILLON. We would not only be willing to, we would very much hope that we can have that privilege, so we can work more rapidly to expedite the work of the committee.

Senator DOUGLAS. Mr. Chairman, I hope very much that the staff of the Joint Committee on Internal Revenue Taxation may be instructed to work with the Treasury, and I am sure there will be no difficulty with the legislative counsel of the Senate.

Now, Mr. Secretary, I asked you a question yesterday about the public statements of Mr. George E. Barnes of Chicago with regard to nonreporting of dividends.



I thank you for the memorandum which you have prepared in reply to that. I ask that this be made a part of the record. I hope that you have sufficient copies so that they may be given to the press at the same time.

Senator Gore. Without objection it will be printed. The Chair would like to say to the Secretary that Senator Morton, who had to depart just a moment ago, asked me to state that he thought his questioning would consume something less than 30 minutes.

Senator Williams has a few questions, but said it would not be long. Senator McCarthy and Senator Douglas have both indicated their questions would be of less than 30-minute duration so it is our hope that we might conclude with your testimony by about 4.

Thank you, Mr. Chairman.

The committee stands in adjournment until 2:30.

(Whereupon, at 12:30 p.m., the committee was recessed to reconvene at 2:30 p.m., the same day.)

#### AFTERNOON SESSION

Senator Gore (presiding). The committee will come to order.

#### STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE U.S. TREASURY—Resumed

Senator Gore. Senator Douglas?

Senator Douglas. In view of the fact that the Senator from Kentucky waited for 2½ hours this morning to ask questions and I understand he has a plane he wants to catch, I will waive my priority in favor of the Senator from Kentucky and he can go ahead.

Senator Gore. The Senator from Kentucky.

Senator Morton. I appreciate that; my plane doesn't leave until 5 o'clock.

Senator Douglas. Go ahead.

Senator Morton. I appreciate it very much.

I will try to be brief. I feel it is the desire of the committee and the Secretary to terminate these hearings this afternoon. Mr. Secretary, I would like to commend you for your patience. One of the prices that I pay for being so junior on this committee is that I, too, am required to exercise a degree of patience.

I am disturbed, sir, about some of the basic philosophy of this bill when compared to the basic philosophy of certain other programs of this administration.

As you know, I have been a supporter for many years of the international foreign policy of this country, economic and otherwise, under this administration, the Eisenhower administration, and the Truman administration.

As a freshman Member of the House, I voted for the Marshall plan and programs of that nature. I find myself now as if I were sailing a very tight triangular course with permission to change course in order to win the race, but with orders that I can't trim my sheets in any way.

I think that what we are trying to accomplish here in the abused tax-haven areas is laudable but in attempting to do this, I am afraid

we are taking positions that are somewhat contrary to our other policies. I was impressed with the President's speech in New Orleans. I was impressed with your very dynamic sponsorship and leadership in the development of our Alliance for Progress program, and I am just wondering if in order to get rid of a few undesirable rodents we aren't burning one of the best burns on the farm.

Now, specifically, as I get this, we are being told that there are certain areas which need attention based on certain assumptions.

No. 1 is that money earned by foreign subsidiaries is not returned to this country.

The facts, I think, disprove that. Our acting chairman, my distinguished colleague from Tennessee, told us on March 1 "that having gone into bricks, mortar, and machinery in Europe these profits never come back to the United States to be taxed in such an instance deferral extends into eternity."

Isn't it true, Mr. Secretary, that in the 11-year period 1950 through 1960, inclusive, we repatriated earnings in the area of \$20½ billion?

Secretary DILLON. On a worldwide basis, I think that is the correct figure. But, of course, our suggestion only applies to developed countries.

Senator MORRIS. Yes; I realize that and I was speaking on a worldwide basis.

Now, if we go to the American subsidiaries in Europe, I understand that the figures came from the Department of Commerce that from 1957 through 1959, these subsidiaries distributed an average of 53 percent of their earnings to their U.S. parent corporations.

Would you question that figure?

Secretary DILLON. I am not aware of the exact figure for those particular years. That figure is a little higher than the average figure, which runs about 45 percent.

Senator MORRIS. Well, those 3 years may have been higher than a longer term average but at any rate I think you will agree that it is approximately the same as the policy adopted by U.S. corporations in determining their dividend payments to their stockholders. I think U.S. corporations pay out about half of their after tax earnings as a general rule.

Secretary DILLON. The figures we have generally show it was slightly less, for foreign subsidiaries—maybe in the neighborhood of 10 percent less, not very much. But the big difference occurs, in the figures that we have, in respect to earnings in so-called tax havens, where the percentage returned, as I said this morning, is very much less—only about 15 percent is returned.

Senator MORRIS. Speaking of tax havens, I recognize this problem, and I am sympathetic to your desire to do something about it. I realize that in recent years and recent months, really, the last 36 or 38 months there has been a terrific increase in incorporation of U.S. subsidiaries in Switzerland, Nassau, and so forth, and I want to do something about it.

But I am concerned that in what we are trying to do, we destroy something else which I think makes a terrific contribution to our economy, to jobs here, and to returns to the U.S. Treasury in the form of taxes.

According to reports I have and figures which have been submitted in this 11-year period I have already referred to, 1950 to 1960, the return on a worldwide basis was about \$8½ billion more than the investment of capital from this country in overseas operations, subsidiary operations.

Secretary DILLON. They aren't all subsidiary operations. The overseas operations in underdeveloped countries are largely branch operations which pay taxes at U.S. rates.

Senator MORRON. In branch and subsidiary operations?

Secretary DILLON. Yes, worldwide, I think that is correct. The fact of the matter is that there was a very substantial net inflow from the less developed countries, and a rather smaller net outflow to developed countries, on the same basis which gives you your figure of \$8½ billion when you add the two together.

Senator MORRON. So we are not approaching this problem then because money is never returned to the United States. I mean the reasons are other than that. We can eliminate that as the reason for this bill.

Secretary DILLON. Well, one of the reasons behind this bill is that we feel it will help our immediate current balance of payments situation. Certainly when new investments are made that money takes time to come back. I think we have had some very detailed figures on that which indicate that the current investments do not return the capital for 12 or 15 years.

We are not, however, asking this simply as a matter of balance of payments.

We felt it was an overall matter of equity because there is no further need to have extra tax inducements to go abroad.

Now, we do not want, as you said, to hurt any legitimate businesses abroad, and I use legitimate in the sense of businesses that were not created for tax reasons. I think, of course, that applies to the great bulk of our investments abroad and I think they will continue.

Senator MORRON. On this matter of balance of payments, you are properly concerned with it, as are other officers of the administration, as I think are the Members of the Congress.

However, I cannot see that the prevention of—that by trying to dissuade capital investment in foreign-owned subsidiaries through a tax mechanism that we are necessarily going to improve our balance of payments position. The one thing that I note with some fear and alarm is the flow of American capital today into strictly foreign operations. I have here some copies of clippings from April issues of the New York Times. On April 4 it reported the financing slated by the Philips Lamp Co. Now it is estimated that somewhere in the area of \$400 million in equity capital is to be raised in this country through the sale of some form of common stock in this Dutch company. Now it is going to take a long time under the terms of this bill, to slow up the investment of \$400 million in American companies for foreign oversea operations.

On April 20, another clipping from the New York Times—

financing for the Japan Fund, Inc., was completed yesterday and the managing underwriters handed over a check for \$14¼ million to managers of the new closed-end investment company.

This investment company is to have 80 percent of its investments in Japan.

There are other examples of this.

I hope that in approaching this problem that we do not further encourage a lack of confidence in American corporations whether or not they have foreign subsidiaries, and this outflow of capital into foreign investments. This disturbs me. I think the ideal solution to this problem would be to create a climate in which persons would want to invest in U.S. companies. If we are so desperate with respect to balance of payments, we might have to adopt the British procedure or something of that nature in which we just plain control the outflow of capital. I hate to see us use this tax mechanism which has been traditionally with us since 1913 to suddenly accomplish a short-term end to improve our balance of payments or stop the outflow of capital. I did not think from your remarks yesterday you were too happy about having to approach this from a tax angle but you seem to feel that, this is about the only way we can do it now.

Secretary DILLON. Well, I would like to answer a number of things: First, regarding the details of this Philips transaction, the story as printed at that time turned out to be not accurate.

Further study shows that the amount of funds that the Philips people feel that this offering will, when it comes, taken from the United States or from U.S. capital sources, is in the neighborhood of \$60 or \$70 million. It is their feeling that all of these funds will be re-invested in their own operations here in the United States, so this operation would not overall have much, if any, balance of payments impact on the United States.

These other offerings do have some impact, and I share your concern about them.

They do not have the same impact as their total volume implies, although I would say that the example you used in Japan probably does. But many of the European issues are purchased in turn by Europeans with dollars which they own. So in effect the Europeans are using the American market to make their own investments. The only new dollars they are taking out are a percentage which is probably not much more on the average than a third of the face value of the issues. Nevertheless even that third is a matter of concern and in this area we are working very hard with the various European countries; to see if we cannot help them to develop more effective capital markets of their own so they raise their own capital at home rather than being in a situation where their own nationals have to make use of our capital markets in a round-about way to invest in their own properties. That is something which we are making some progress on and hope it will continue.

Certainly, we have felt, in view of the importance of the dollar world-wide as a reserve currency, that the last thing we wanted to do was to adopt capital controls, exchange controls.

You expressed, if I understand it, a preference for that to legislation in the tax field. My view would be different. I feel that it is better to try to control this tax inducement, and particularly the inducements posed by the use of tax havens, which you also mentioned you thought something should be done to control. We feel their use has led to a significant portion of this outflow.

Now our balance of payments deficit runs at an average of, say \$2 to \$2½ billion. This is the basic deficit, not counting the short-term

flows. If by eliminating this special inducement, we can save as much as \$400 million, that is a very significant percentage of the deficit. Since we are making other savings in other places, it may be enough to bring our payments overall into balance. I would feel that that sort of legislation is preferable to moving to control capital.

But, of course, that is something that can be debated, but it is our feeling that it is much preferable.

Senator MORRISON. I certainly hope we do not have to move to control capital and I hope we can find a means of stopping these abuses, in the tax-haven field in some manner short of upsetting what has been a time-honored method in this country, a philosophy which certainly was not born yesterday or even born post-World War II.

I think that one misconception that the public has gotten in the presentation of this proposal is that certain loopholes were deliberately set up in the post-World War II years in order to encourage an outflow of capital, especially to Western Europe, at the time that the Marshall plan went into effect, at the time the reconstruction was necessary.

I again quote from the acting chairman of our committee. He said, February 12:

The need for such a policy ended in 1954 or 1955.

He previously said:

There may have been justification for a policy of tax incentive to encourage such investments—

and the President addressing the AFL-CIO Convention this year said:

We passed laws in the days of the Marshall plan when we wanted capital over there and as a result of that there are provisions on the tax books which makes it good business to go over there.

We passed some laws then that had something to do with taxes. But basically this goes right back to 1913. I mean certainly—

Secretary DILLON. Basically you are correct on the time. But certainly there was a very strong reason for not interfering with this policy, which goes back a long way, the time of European recovery. I think what Acting Chairman Gore meant, as I gathered from what you said, was that that reason disappeared in 1954, and that reason no longer existed.

I do not think there was the implication that these laws were adopted specifically at that time, because they did go way back.

But the volume of investment increased very much after the war, and particularly after the creation of the Common Market. In the present circumstances we do not see a need for real tax inducements to invest abroad, which in earlier days did not have so much effect because people were more interested in investing here in the United States. I think fewer investments were made abroad for tax reasons than may be the case today.

Certainly the widespread use of tax havens was a very new occurrence, and by very new, I mean the last 5 or 6 years.

Senator MORRISON. There, Mr. Secretary, we are in absolute agreement. Here is a new occurrence and I should hope we could develop legislation that will deal with it, but not upset this very complex and proven system that has developed throughout the century.

Ford Motor Co. went to Canada in 1905. There certainly was no tax motive involved there. That was before we even had an income tax.

They went to England, I think in 1911. They went to Germany in the early 1920's. They made a good case to show that they are actually not exporting jobs but that they are giving jobs to people in this country today because of their holdings in these subsidiaries, and that their suppliers are supplying these subsidiaries. They are U.S. suppliers as a result of an exchange of engineering and management techniques.

Now, this system of ours, call it what we will, a free-enterprise system, a corporate system, is complex. It is like the nerve system of the human body. You cannot just turn it off and on like a spigot. I am somewhat apprehensive about that. I do not want to see us take a step here that will show us 2 or 3 years from now that we have actually done something that is counterproductive. The American corporate system cannot be compared to Pavlov's dogs; I mean we cannot ring a bell and have them salivate and then quit. This thing has grown up over the years, and there are so many companies giving so many jobs in this country providing such a large portion of our revenue to our Federal Government that are not using these tax havens in any way that will have to take a new look at their foreign operations if we pass this bill. I think it would kill just the thing we are trying to accomplish. You have no worry on that score.

Secretary DILLON. Well, I think that the tax-haven problem is, of course, by far the most acute, both for reasons of equity, with which you agree, and also by reason of the fact that in tax havens the tax is 8 percent or 5 percent or zero.

Now the elimination of deferral generally involves a much more minor tax adjustment. Tax rates in many of these other countries are equivalent to ours, although it is true in some of them there are special things in the law which mean that the tax rate that is published does not turn out to be an effective rate. But even allowing for those, the difference in what we are talking about is increasing a tax rate from maybe 40, 45 percent to 52 percent. That is not something which will change the whole course of American business, although I can well understand why companies that have been operating under one system prefer not to have it changed. But our feeling at the time of our original testimony and our feeling today is that if this proposal is adopted, 90 percent of the new investment that has been going overseas will continue, and I think that the bulk of the 10 percent that will be stopped will be stopped on account of tax-haven provisions, and only a smaller part on account of overall deferral.

Certainly one advantage of the overall deferral, and one of the reasons we favored it, is that tax-haven legislation of the type that you favor, and which is absolutely essential, is complex to draft, so as to limit it properly. It seemed much simpler to have the overall deferral approach which did not seem to hurt manufacturing businesses. But I do recognize that that opinion is not shared by the businesses that are manufacturing overseas. They seem to think that it will be a very substantial injury to them.

Senator MORROW. Even those who make no use of the so-called tax-haven countries, if I can measure the traffic coming through my office. Many responsible business executives disagree with you.

Secretary DILLON. I said that at the end; I recognize that they disagreed.

Senator MORTON. Yesterday, I thought you offered some points that improved the House bill substantially, and I, too, look forward to getting the specific language suggestions from your technicians at the proper time.

I would like to comment on one feature which is technical, and I do not know that I understand it too well myself, but it is this so-called gross-up, in section 11 of the bill.

Now, I bring this up because I think it is exactly opposite to the policy that we are trying to pursue under our Alliance for Progress.

As I recall, it was indicated that we hoped to be able to put a billion to a billion and a quarter of capital into the hemisphere in the next 10 years—that is per annum—and we hoped that \$300 million of this could be from the private capital sector.

Now, the ARMO Steel people worked out this chart. They have some experience in this matter. I am happy to say their investments in my State exceed their investments in any foreign country. They have taken a hypothetical situation here in which a company earned \$2 million, a subsidiary, has income before taxes of \$2 million in Latin America, in England, and in France.

Under the present law, that companies total—and I interpose this, that all of the earnings after taxes in the foreign country are returned, there is a 100-percent dividend payout.

The total taxes today, U.S. and foreign, in the case of the Latin American company, would be \$926,000. In the case of the British company \$1,075,000, in the case of the French company \$1,150,000. Under the proposal, section 11, and I do not think you suggested altering this yesterday, the tax from the British company and the French company would remain unchanged. The tax from the Latin American company would go up \$113,500 or 5.68 percent. It seems to me that the application of this formula would have a directly opposite effect to what we want in encouraging private capital to the tune of some \$300 million a year to assist in the implementation of our Alliance for Progress program. Am I completely off base on this or do you think I am right?

Secretary DILLON. No; I have heard that argument made. The fact is that the gross-up provision will operate most heavily as to countries which have corporate tax rates half way between zero and 52 percent. In other words, at the 26 percent bracket and around there, it would have a substantial effect. For instance on a subsidiary in Italy which is not mentioned in that example.

In the case of an underdeveloped country, if one would take India, it would have no effect at all, because it happens that corporate tax rates in India are very high.

When they talk about Latin America, they err. I do not know what country in Latin America they are talking about, but let's assume that that is a fair average for all of Latin America.

Senator MORTON. This is an average of three countries in which they have plants.

Secretary DILLON. We had a table in my original statement which showed that under the present law for \$100 of earnings if the tax rate was at 26 percent of the foreign country, you would actually

pay when you got through sending your earnings home \$45.50 as against \$52. The difference there is \$6.00, and here they said it would be \$5.70, pretty near the maximum. As you said, this was a 5.7-percent difference on their total tax at the end of the road. Certainly I do not think that any company is going to be influenced in the slightest, one way or another in making an investment in Latin America by figuring that the final tax rate is going to be 52 percent or 45½ percent. They are going to be influenced by the chances of profit and by consideration of the safety of investment, currency convertibility, and other such matters, which are so much bigger than this rather minor difference of whether their profits will be taxed 45½ percent or 52 percent. And I certainly think it is a matter of equity. In this case it was just our feeling that this is a general matter that probably should have originally operated in the way we are suggesting.

As a matter of fact, I think you are probably aware of the fact that this particular change was presented by the previous administration as well, and has been long under consideration. It has been backed by both Treasury administrations for some time.

Senator MORRIS. Of course, I think you and I can agree that we want to build the most efficient competitive industrial complex that we can. We know we are in a much more competitive world industrially than we were at the end of World War II, and I hate to see us get into any program where that ability to compete is in any way impaired because of the change in our basic philosophy of taxation, which has always been that you paid the tax when you got your hands on the money.

I know there are States in this Union that are competing for industry by giving tax inducements; many of the Southern States are doing that.

I understand that in Italy they are trying to develop industrially in southern Italy and they are giving tax inducements. I should hate to see us foreclosed from any opportunity to participate in that development as opposed to, let's say, the French or the German industrialists because we pass a program here that eliminates the tax advantage or incentive that was offered by southern Italy.

Of course, I do not like to see the State of Mississippi offer a greater tax advantage than the State of Kentucky, but I have to put up with it now and then, I guess.

Secretary DILON. The type of incentive that you are talking about in Italy would be probably far more important than what the State of Mississippi could do versus the State of Kentucky.

And it is our feeling that we do not see why this kind of tax inducement should be part of our law and encourage our companies to go abroad instead of investing in something that might be profitable in this country.

I am not saying there is any shortage of funds overall, but I am saying that if a company has the alternative of building a factory in the United States—since you mentioned Kentucky, Kentucky—or in southern Italy, where there is no tax or a very small tax, they would be inclined to go where there is less tax. They would be inclined to do that even more after tariffs have been reduced so it would be easy to send the product back into the United States.



What we are trying to do is remove to the extent possible both extra inducements to capital to flow abroad and barriers to capital movements, and that is exactly the same thing we are trying to do with goods, to remove barriers and also to remove special subsidies and things of that nature.

So I do not think that these two are totally inconsistent in concept. It is difficult for me to understand that.

Senator MORRISON. I do not think that the final determination in putting a plant in South America, southern Italy, or anywhere else. In the final determination—

Secretary DILLON. I agree with you.

Senator MORRISON. The final determination of management is whether or not it is going to be a profitable venture.

Secretary DILLON. Taxes enter into profits.

Senator MORRISON. Yes, but the final determination is a factor of whether or not the foreseeable gain is greater than the foreseeable risks and certainly in these investments there is quite a risk such as expropriation.

Secretary DILLON. Yes, I would agree with you a hundred percent and that is why we think this legislation will not greatly reduce investments abroad, and that is not our intention. But it will remove this one factor, which is a factor, as you said, in making the final decision, and we think it would have some effect. There must be some marginal cases where that happens to be the final straw that weighs the balance in one direction or another.

Senator MORRISON. I think there are probably too many in this country today, and too many in the Congress and on this committee who do not recognize the fact that the reason the plant is in France is to compete with the French company or the German company that has a subsidiary in France, the reason it is in Italy is to compete with an Italian company and that these U.S. subsidiary companies are not competing with U.S. domestic companies. I hate to see us set up ground rules here that make it more difficult for American-controlled corporations to get their share of the market. I hate to see us stimulate investment by American citizens in corporations which America does not control, and in which no profit comes back here for taxation except those dividends of the stockholders themselves. I hope that we can get at this tax-haven problem in executive session and find a solution, even though it may be a complex one, that will relieve me of my apprehensions on this.

I do not want to delay this; there are just a few other small points, one or two other points, Mr. Secretary.

I read with great interest and studied carefully the item 3 or annex 3, that rather lengthy statistical document. I would like in executive session, with technicians in your Department, to discuss some of the specifics in that, but I won't hold you or the committee at this time.

Let me ask just this one question: Was that worked out in conjunction with the Department of Commerce or is that a Treasury document?

Secretary DILLON. It was worked out by an individual consultant which the Treasury obtained from the outside, using Commerce figures. All the results were shown to the Department of Commerce and to outside people as we moved along to check. I think there was general agreement that there weren't any errors in the calculations, but the responsibility for the document was a Treasury responsibility.

Senator MORTON. So far as you know, Commerce took no exception to it.

Secretary DILLON. Not to the figures. I do not think they took any exception to what it proved, or what it seemed to show, because I think they agreed with the formulation of the figures after they listened as to how they were formulated.

Senator MORTON. Getting off this foreign subsidy feature of the bill, just one other subject: I have been somewhat concerned, and we on the committee have been approached by many industries, as to this question of expenses.

You have been close to business. Is it not true that any business expense, whether it is for entertainment or for painting the mill, in 99½ percent of the cases is made on the judgment of whether it is good business and not on the fact that 52 percent is paid for by the taxpayer?

Secretary DILLON. I think the fact that a substantial amount is deductible is a very strong factor in the decision in many cases.

Certainly I would think the testimony here indicates that, because there is nothing to prevent companies from carrying on any kind of entertainment they desire at their own expense if it is purely for business reasons. The complaint has been that this removes the 52-percent tax deduction. So I cannot but feel that that does influence the volume and amount of entertaining that has been done.

Senator MORTON. I can understand that at times when we had the excess-profits tax and it got up to whatever it was—80, 85 percent—that business got lax generally as to its expenditures on the theory that 85 percent was paid for by the taxpayer. But I must say I have run a business, that we gave our sales manager a certain budget for expenses for his men, which included entertainment, and that the determination of this amount was not influenced by the fact that half of it was going to be ultimately saved to us because our taxes would be proportionately reduced.

The same argument would apply if the foreman came in and said to me, "I want to paint the mill." I say, "I saw the mill this morning; it doesn't need painting." He says, "The taxpayers are paying for half of it; let me paint the mill."

Any business expense, other than a capital investment, comes in the same field as this expense account.

I say it has been abused in certain cases, and my distinguished friend from Illinois has recited time and again to this committee his chamber of horrors, as I call it.

Senator DOUGLAS. I have many more examples, Senator, many more.

Senator MORTON. You have got me so interested in that \$251,000 yacht I would like to take a ride on it. [Laughter.]

I must say that in the overwhelming majority, in 99 percent I will say, of the cases the determination of what a sales force spends for entertainment is considered in the same light as what is spent by the plant manager for repair and maintenance of the plant.

There have been abuses in hunting lodges and yachts. These abuses, I think, come at high levels in the companies, top management levels, but I think, by and large, the determination that is made is a sound business determination, and I hate to see us go too far in injecting the Government or the Internal Revenue Service or anyone else into saying what is or what is not a good business judgment.

I think in the final analysis that most of them are made on that basis. The company still pays some of it, just as they pay something for, as I say, painting the mill.

Secretary DILLON. Well, Senator, one of the places where this problem becomes much more serious and one of the biggest areas of difficulty for the Internal Revenue Service, which we think needs to be corrected lies in family-owned corporations where the individual who is running the business is also the officer, and where his profits from the business and his way of life and what he does are all more or less wrapped up into one and are indistinguishable. There it becomes very difficult to determine whether a decision to make certain expenditures was taken because of the needs of the business or because of the benefits that would accrue to this individual himself, because he and the business are one and the same thing.

It is for this reason that we feel that this area where entertainment gives a special personal type of benefit, that this area needs attention in our tax laws. It is for this reason we made the recommendations that we have in this particular area.

I agree with you with regard to the setting of an expense account budget by many of the major manufacturing companies, publicly owned companies. I don't think they sit down and figure out that they are going to give a bigger budget because the Government pays half of it, but I dare say that if there is a change in the tax law, we will see that entertaining budgets are probably lower in the future than they have been in the past; because I don't think entertainment is ever quite as profitable as painting the mill.

Senator MORTON. I agree there have been abuses.

I don't deny that. But I wanted to get for the record the fact that I am afraid we are giving out the opinion to the public that it is the judgment of this committee and the weight of the testimony that all expense accounts are subject to be suspect and that, of course, is not the case. I mean, take advertising, I don't think there is a man in the world who is going to say how much I am going to get out of this page I am buying in the Women's Home Companion, how many cases I am going to sell.

But they hope that they are going to sell more than the page cost by a sizable amount.

The trouble with advertising is you can't measure it too definitely and you can't afford not to do it in this competitive merchandising field in which we find ourselves today.

I thank you again, Mr. Secretary.

And I probably have run beyond the time I said.

Thank you, Mr. Chairman.

Senator GORE. Senator from Illinois.

Senator DOUGLAS. Thank you, Mr. Chairman.

I will try to be very brief, Mr. Secretary, because I know the pressures you are under and we are very anxious to get you off to Rome so that the committee and staffs may proceed with their work.

At the conclusion of the session yesterday morning I asked you a question about the latest estimates on the amount of dividends and interest not reported on the returns, and also the amount that belonged to taxable individuals.

The previous figures which you had given applied to 1959 and came to a total of approximately \$3.8 billion and around \$3 billion taxable.

Now, at the end of the session you were introducing figures for 1960, and in rereading the record on typescript page 4020 I find the reply not fully illuminating due to the haste with which we had to move. I wondered if now you would state what your estimate is for 1960, (a) on total amount distributed in dividends and interest; (b) total amount not reported; and (c) the total taxable amount not reported.

Secretary DILLON. I don't have right here the total amount distributed, but as a result of your question we have gotten the figures together, and they closely approximate what I mentioned yesterday.

For 1959, the total reporting gap, that is the amount of dividends and interest that should have been reported and was not, was \$3,807 million, which is about \$70 million higher than the earlier figure.

For 1960, the comparable figure as I said yesterday went up about \$600 million, and the figure is \$4.4 billion.

Senator DOUGLAS. What is your estimate as to the amount of taxes thus lost through nonreporting?

Secretary DILLON. Well, the total reporting gap of taxable income went up from \$2.9 billion to \$3.3 billion in 1960, and the total revenue loss went up from about \$870 million in 1959 to a total of \$980 million for 1960.

Senator DOUGLAS. Just short of a billion dollars?

Secretary DILLON. For 1960. That is right.

We have been using the figure of \$650 million for revenue gained from withholding in 1959. That figure should be slightly higher now, because of the increase in the dividend gap. About \$660 or \$670 million would be the right figure. A similar figure for 1960 would be \$780 million.

Senator DOUGLAS. This increase in the gap has occurred despite the fact that the Treasury made special efforts to require reporting, is this true?

Secretary DILLON. That is correct.

Senator DOUGLAS. And despite these special efforts it has increased and not diminished.

Secretary DILLON. That is correct. Actually what has happened is that the percentage gap has not changed much in the field of interest, but the dollar gap has gone up because interest payments have increased as the economy has grown.

In the case of dividends, the percentage gap itself has increased somewhat also as more dividends are being paid.

Senator DOUGLAS. You make this estimate, after having considered the criticisms of Mr. Barnes which I submitted to you yesterday.

Secretary DILLON. Oh, yes. His figures relate only to dividends and his computations had two very substantial errors in them.

The figures we have used and the method of computation we used have been checked with and agreed to by the New York Stock Exchange, so there is no problem on that. But his computation was very erroneous.

Senator DOUGLAS. I put your reply to Mr. Barnes in the record. You have sent him that memorandum and made it available to him?

Secretary DILLON. No, I have sent him a letter. This memorandum is just a brief of that about a page and a half long. I sent him about a three-page letter explaining in some detail where he went wrong in his figures.

Senator DOUGLAS. Well, would you provide for the record a detailed breakdown on these figures of 1960?

Secretary DILLON. We would be glad to; yes.

Senator DOUGLAS. In view of the importance of this matter, may I ask if I correctly understood your reply?

You formerly, as I understand it, testified that the gain in revenue derived from withholding would be approximately \$650 million a year, is that correct?

Secretary DILLON. That is correct. That is the figure we had used.

Senator DOUGLAS. That is now raised to \$780 million?

Secretary DILLON. That is based on the 1960 data.

Senator DOUGLAS. That is correct.

This bill does not go into effect until the taxable year 1963, is that true?

Secretary DILLON. That is correct.

Senator DOUGLAS. Have you made any estimates as to what the gap is likely to be for taxable 1963, and the amount which is lost in taxes and the amount which would be gained by withholding for calendar 1963?

Secretary DILLON. Yes. That is naturally a difficult thing to do, but on the assumption that the interest reporting percentage gap remains constant, which it has over the past years, and that, therefore, the amount of gap increases as more interest is paid out—as you know, savings are growing very rapidly—we figure that on the most conservative basis that we can possibly use that the revenue loss in 1963 would be in the neighborhood of a billion dollars.

Senator DOUGLAS. That is total?

Secretary DILLON. Revenue loss, yes.

Senator DOUGLAS. Yes.

Secretary DILLON. And it might well be more but we are trying to be conservative. This is the most conservative basis possible. The revenue gained from withholding would approach \$900 million.

Senator DOUGLAS. These are very significant figures and I am glad to have them for the record and you will submit detailed worksheets justifying this estimate.

Secretary DILLON. We will be glad to.

(The data referred to follows:)

*Summary of gap and revenue<sup>1</sup> data 1959, 1960, and projected for 1963*

[In millions of dollars]

	1959	1960	1963
Reporting gap:			
Dividends.....	1,030	1,330	1,300-1,500
Interest.....	2,777	3,070	3,600-3,700
Total.....	3,807	4,400	4,900-5,200
Taxable reporting gap:			
Dividends.....	910	1,180	1,240
Interest.....	1,940	2,150	2,520
Total.....	2,860	3,330	3,760
Revenue loss:			
Dividends.....	370	420	440
Interest.....	500	560	670
Total.....	870	980	1,090
Revenue gain from withholding.....	670	780	980

<sup>1</sup> Assumes retention of dividend received credit and exclusion.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 14, 1962.

*Revenue effect of withholding on dividends and interest under H.R. 10650  
(based on 1960 data)*

[In millions of dollars]

	Dividends <sup>1</sup>	Interest	Total
A. Total estimated gaps.....	1,330	3,070	4,400
To nontaxable filers.....	150	920	1,070
To taxable filers.....	1,180	2,150	3,330
B. Revenue gain from complete enforcement.....	420	560	980
C. Revenue gain from 20-percent withholding only.....	220	360	580
D. Estimated improvement in upper income brackets due to withholding.....	160	50	200
E. Revenue gain from withholding plus estimated improvement in upper income brackets (C)+(D).....	370	410	780

<sup>1</sup> Assumes retention of dividend credit and exclusion.

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

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 14, 1962.

*Revenue effect of withholding on dividends and interest under H.R. 10650  
(based on revised 1959 data)*

[In millions of dollars]

	Dividends <sup>1</sup>	Interest	Total
A. Total estimated gaps.....	1,030	2,780	3,810
To nontaxable filers.....	120	830	950
To taxable filers.....	910	1,940	2,800
B. Revenue gain from completed enforcement.....	370	500	870
C. Revenue gain from 20-percent withholding only.....	170	320	490
D. Estimated improvement in upper income brackets due to withholding.....	130	50	180
E. Revenue gain from withholding plus estimated improvement in upper income brackets (C)+(D).....	300	370	670

<sup>1</sup> Assumes retention of dividend credit and exclusion.

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

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 14, 1962.

*Estimated dividend income of individuals not accounted for on tax returns for  
1960*

[In millions of dollars]

Cash distributions to stockholders by domestic corporations, statistics of income.....	1960
Domestic dividends received by domestic corporations, statistics of income, less dividends received from Federal Reserve banks.....	<sup>1</sup> 17,180
Net dividends paid by domestic corporations.....	14,090
Domestic dividends paid abroad.....	-520
Foreign dividends received by individuals.....	+130
Distributions paid to individuals, fiduciaries and tax-exempt organizations.....	13,700
Distributions of small business corporations taxed as partnerships.....	-230
Distributions taxable as capital gains.....	-490
Dividends received by corporate pension funds <sup>2</sup> .....	-450

<sup>1</sup> Estimate based on relationship to dividends as estimated by Department of Commerce.

<sup>2</sup> Estimate limited to corporate pension funds as defined by SEC. Joint, union-controlled and nonprofit institution funds are included with other tax-exempt organizations.

*Estimated dividend income of individuals not accounted for on tax returns for 1960—Continued*

[In millions of dollars]

	1960
Dividends received by other tax-exempt organizations <sup>1</sup> -----	-540
Dividends received by persons not required to file or who use 1040-A-----	-130
Dividends retained by estates and trusts-----	-420
<b>Total deductions</b> -----	<b>-2,460</b>
<b>Dividends includable on individual tax returns</b> -----	<b>11,240</b>

Dividends reported on individual tax returns-----	9,910
Dividend reporting gap-----	1,330
Attributable to nontaxable filers-----	150
Attributable to taxable filers-----	1,180

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

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 8, 1962.

*Estimated dividend income of individuals not accounted for on tax returns for 1959*

[In millions of dollars]

	1959
Cash distributions to stockholders by domestic corporations, statistics of income-----	16,230
Domestic dividends received by domestic corporations, statistics of income, less dividends received from Federal Reserve Banks-----	2,930

<b>Net dividends paid by domestic corporations</b> -----	<b>13,300</b>
Domestic dividends paid abroad-----	-440
Foreign dividends received by individuals-----	+120

<b>Distributions paid to individuals, fiduciaries and tax-exempt organizations</b> -----	<b>13,070</b>
--	---------------

Distributions of small business corporations taxed as partnerships-----	-210
Distributions exempt from tax-----	-200
Distributions taxable as capital gains-----	-510
Dividends received by corporate pension funds <sup>1</sup> -----	-380
Dividends received by other tax-exempt organizations <sup>1</sup> -----	-510
Dividends received by persons not required to file or who use 1040-A-----	-130
Dividends retained by estates and trusts-----	-400

<b>Total deductions</b> -----	<b>-2,330</b>
<b>Dividends includable on individual tax returns</b> -----	<b>10,740</b>

Dividends reported on individual tax returns-----	9,710
Dividend reporting gap-----	1,030
Attributable to nontaxable filers-----	120
Attributable to taxable filers-----	910

<sup>1</sup> Estimate limited to corporate pension funds as defined by SEC. Joint, union-controlled and nonprofit institution funds are included with other tax-exempt organizations.

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

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 8, 1962.

*Estimated interest income of individuals not accounted for on tax returns for 1960*

[In millions of dollars]		1960
Interest payments to individuals:		
Cash interest paid on Government securities <sup>1</sup> .....		1,700
Interest paid on corporation bonds and notes <sup>1</sup> .....		890
Interest on time and savings deposits <sup>1</sup> .....		2,900
Interest on savings shares <sup>1</sup> .....		2,420
Interest paid on holdings of foreign bonds.....		80
Interest on farm mortgages paid to nonfarm individuals.....		260
Interest paid on nonfarm mortgages.....		1,430
Interest paid to unincorporated brokers and dealers.....		100
Interest paid to unincorporated consumer credit companies.....		180
Interest paid on life insurance dividends left to accumulate.....		100
Interest paid to retail auto dealers.....		40
<b>Total payments</b> .....		<b>10,090</b>
Deduct:		
Interest reported as business income by sole proprietors.....		520
Interest received by low income individuals not required to file.....		210
Interest receipts of nonprofit organizations.....		330
<b>Total deductions</b> .....		<b>1,060</b>
<b>Interest includable in individual tax returns</b> .....		<b>9,030</b>
Interest reported as such on tax returns:		
Individuals—Form 1040.....		5,060
Individuals—Form 1040-A.....		20
Partnerships.....		360
Fiduciaries.....		520
<b>Total</b> .....		<b>5,960</b>
<b>Estimated amount of interest payments not accounted for</b> .....		<b>3,070</b>
Attributable to nontaxable filers.....		920
Attributable to taxable filers.....		2,150

<sup>1</sup> These items include payments to nonprofit organizations.

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

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Apr. 27, 1962.

*Estimated dividend gap 1956 to 1960*

[In millions of dollars]

	1956	1957	1958	1959	1960
Dividends includible on individual tax returns.....	9,983	10,283	9,975	10,740	11,240
Dividends reported on individual tax returns.....	8,892	9,432	9,058	9,710	9,910
Dividend reporting gap.....	1,091	851	917	1,030	1,330
Dividend reporting gap as a percentage of dividends includible on individual tax returns.....	<i>Percent</i> 10.9	<i>Percent</i> 8.3	<i>Percent</i> 9.2	<i>Percent</i> 9.6	<i>Percent</i> 11.8

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 8, 1962.



*Estimated interest gap 1956 to 1960*

[In millions of dollars]

	1956	1957	1958	1959	1960
Interest includable on individual tax returns.....	5,520	6,409	6,894	7,984	9,030
Interest reported on individual tax returns.....	3,453	3,990	4,368	5,207	5,960
Interest reporting gap.....	2,067	2,509	2,526	2,777	3,070
Interest reporting gap as a percentage of interest includable on individual tax returns.....	Percent 37.4	Percent 38.6	Percent 36.6	Percent 34.8	Percent 34.0

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 8, 1962.

Senator DOUGLAS. Now, Mr. Secretary, I have received over 40,000 letters from constituents in Illinois protesting against the withholding tax. I am happy to say by Monday we expect to have answered everyone of them.

I want to thank my staff for the work they did in this connection.

Now, in analyzing these letters, we have tried to make our answers responsive, I have found what I believe to be five key points of misunderstanding about the withholding provisions. I would like to take these up with you in turn. Some can be very briefly answered by you and I think it is important to have the answers brought together.

The first and most common objection which we find in approximately one-third to one-half the letters is that this withholding is a new tax.

Secretary DILLON. Well, of course, that is not the case. It is merely a method of collection of a tax that has been on the books for many years.

Senator Douglas. Now, the second most common objection is that this is a tax on 20 percent of the principal of the savings account rather than 20 percent of the interest on the savings account.

That is if there is a hundred dollars in the savings account, and 4 percent interest, this gives a yearly income of \$4. How much would the tax withheld be on this basis?

Secretary DILLON. It would be 20 percent of \$4, which is 80 cents.

Senator DOUGLAS. 80 cents.

Well, I find again and again the assumption that it would be 20 percent of the hundred dollars or \$20 dollars.

Secretary DILLON. That is part of the general misinformation which is unfortunately very widespread; yes.

Senator DOUGLAS. A third objection is that it would adversely affect widows, orphans, old folks, and low-income groups.

Now, in connection with this objection, may I ask will a bank or savings association withhold on income for those under 18 years?

Secretary DILLON. No. There would be no withholding under 18 years.

There are blanket exemptions there.

Senator DOUGLAS. Would it withhold on those over 18 who reasonably could expect to have no tax liability?

Secretary DILLON. Not if they so inform the bank by filing an exemption certificate, which will be easy to file and readily available.

Senator DOUGLAS. And would there be withholding on nonprofit tax exempt organizations?

Secretary DILLON. No, with the sole exception of coupon bonds where it has proved impracticable to work out anything except a rapid refund procedure.

Senator DOUGLAS. Because of presiding over another hearing I could not be present when you testified directly yesterday, and, may I ask, do I understand that you now propose that the request for exemption need not be made every year but once made can be permanent?

Secretary DILLON. Until revoked, either by the filer or as a result of information developed by the Government.

Senator DOUGLAS. So this request would not be quarterly or yearly, but it would be permanent?

Secretary DILLON. That is right.

Senator DOUGLAS. And it would not have to be made to any association, to separate savings institutions or separate corporations, but would be made to the Treasury?

Secretary DILLON. No, the withholding exemption certificate would be filed with the various withholding agents—the banks in which an individual might have savings accounts or the companies from which he might receive dividends.

Senator DOUGLAS. But in the case of refunds the request for a refund that would only have to go to Treasury?

Secretary DILLON. Yes, that only goes to the Treasury.

Senator DOUGLAS. The fourth objection is that it would be too costly to the private associations and to the Government. I wondered if you would trace through the method by which a savings institutions would withhold.

I know you can do it, but would you mind if I asked a series of leading questions, so that you can reply to each one ad seriatim.

Secretary DILLON. I would be delighted.

Senator DOUGLAS. Would not the savings institution merely credit to the individual 80 percent of the amount earned?

Secretary DILLON. That is correct except where there were exemption certificates.

Senator DOUGLAS. Yes.

Would this require any more posting than at present?

Secretary DILLON. No.

Senator DOUGLAS. Would the savings institution have to report to the Treasury the name, address, and amount withheld for each person?

Secretary DILLON. No.

Senator DOUGLAS. It merely would deduct 20 percent of the total.

Would the person or individual have to have notice from the savings association of the amounts withheld or would not this be given by the simple gross-up procedures on the tax form?

Secretary DILLON. The latter is correct. They would not need special notification.

Senator WILLIAMS. Would the Senator yield at that point?

If the taxpayer did not get a notification from the bank, how would he know how much interest he had?

Secretary DILLON. Because he knows that everything he receives has been withheld on at 20 percent.

Senator WILLIAMS. He would be credited with 80 percent of interest earned on the savings account but if you don't give him notice about the 80 or 20 percent, how does he know?

Secretary DILLON. Because he knows the law is that all savings banks would withhold 20 percent. So he knows that whatever is credited to him is 80 percent of what he got.

Senator WILLIAMS. That is right.

But if a man has a hundred dollars interest, and he has \$80 credited back to his account he has to get some information as to this amount credited in order to compute his tax.

Secretary DILLON. He knows he has the 80 because he knows what is credited to him. That is no different from what the situation is today.

Senator WILLIAMS. But I thought you said the bank did not even notify him about the 80?

Secretary DILLON. Oh, no, I said they don't notify him about the 20.

Senator WILLIAMS. Then they will notify him about the 80 percent.

Secretary DILLON. He has to find out about one of them; that is correct.

Senator DOUGLAS. Has the Senator from Delaware finished?

Senator WILLIAMS. Thank you.

Senator HARTKE. Will the Senator yield at this point?

Senator DOUGLAS. Yes.

Senator HARTKE. Mr. Secretary, how then, if there are some cheaters, how are you going to determine where the cheaters are under this system?

Secretary DILLON. Well, to the extent that there is deliberate fraud, there will undoubtedly be some under this system, as there is under all our other systems. We will just have to use the same means we now use, spot checks, to catch it. But we don't think that it will be any larger here than in any other area of the tax system.

But no part of our tax system is impervious to deliberate fraud.

Senator HARTKE. As I understand it there will be no master sheet on individual names submitted by the institution to the Treasury Department; is that right?

Secretary DILLON. Well, yes. The Treasury will receive, as under present law, reports on payments of interest. In the present law it is on payments over \$600. That might be reduced somewhat, so that we can have a better checkup procedure.

But it will not be necessary to reduce it to the low figure of \$10 or less that would be necessary if you were trying to follow up on every individual account.

The information returns we presently have would be continued except that under withholding I would think, as we stated in the hearings in the House, that it would not appear necessary, once withholding has been enacted, to continue to require information returns of dividends in amounts as small as \$10.

So we would probably raise that amount, and that would considerably relieve the present burden of dividend-paying corporations which now furnish these information returns down to \$10. They would only have to furnish them down to some larger figure.

Senator HARTKE. I misunderstood you. I understood your answer to the Senator from Illinois that there would be just a gross deduction of 20 percent of the overall amount, and no information return would be sent.

Secretary DILLON. All I am saying there is no difference between the situation that presently exists.

Senator HARRIS. You would continue the present setup?

Secretary DILLON. That is correct; no special information return would be needed because of the withholding.

Senator HARRIS. I misunderstood, I am sorry.

Secretary DILLON. Yes.

Senator DOUGLAS. Now, the fifth objection is that the development of automatic data processing renders withholding unnecessary.

I would like to ask a series of subquestions under that heading.

Do I understand that the automatic data processing is going to go into effect gradually, in even stages by the various revenue districts and will not become fully effective until the fiscal year 1965-66?

Secretary DILLON. I think probably it will be the following fiscal year.

Senator DOUGLAS. 1966-67?

Secretary DILLON. Yes.

Senator DOUGLAS. You have made an extremely important point in your previous testimony that automatic data processing merely gives the Internal Revenue Department information. It does not collect the tax. After you receive the information you would have to go out and collect the taxes.

Now, do you have estimates as to the amount of taxes, added taxes, which automatic data processing in the absence of withholding would enable you to collect?

Secretary DILLON. Well, in the absence of withholding and with what we would consider a reasonable extra effort to check up and collect taxes which would be a substantial extra effort, putting on some 3,000 new agents just for this particular purpose on the basis of the figures for 1959, which we have been using, we estimate that out of the \$850 million of revenue loss we might pick up \$200 million by automatic data processing and this extra enforcement effort, these 3,000 extra agents, this is as compared to the \$650 million, now \$670 million that we would collect through withholding so there would be a difference of almost \$500 million.

Senator DOUGLAS. That is when the system is completely in effect?

Secretary DILLON. That is right.

Senator DOUGLAS. But it will go into effect gradually in the meantime.

Now, how much do you estimate you can collect in the fiscal year 1962-63?

Secretary DILLON. Nothing.

Senator DOUGLAS. What?

Secretary DILLON. Nothing.

Senator DOUGLAS. Nothing in 1962-63?

Secretary DILLON. No; because the first time that automatic data processing will apply to individual accounts will be for the individual income tax returns for the calendar year 1962, which will be filed next spring. Then they will only apply to one region, Southeastern United States. So I think it would be infinitesimal.

Senator DOUGLAS. Just a few minutes ago you testified that under withholding for fiscal year 1963 you estimated that you will collect \$900 million?

Secretary DILLON. Calendar year 1963; yes.

Senator DOUGLAS. Therefore, the absence of withholding and the presence of automatic data processing would cost, according to your estimate \$900 million in 1963?

Secretary DILLON. That is approximately correct; yes.

Senator DOUGLAS. In 1964, what is your estimate as to the amount which you would collect by automatic data processing but without withholding?

Secretary DILLON. We have not made any estimates on that basis. We can make them. They would vary from zero for 1963 up to something less than a quarter of the total revenue loss for 1967, which would be \$250 million.

If you wanted to

Senator DOUGLAS. \$250 million at the end?

Secretary DILLON. At the end. So if you wanted to average that you might collect \$50 million a year.

Senator DOUGLAS. \$50 million in the first year, whereas you would have collected \$900 million through withholding.

Secretary DILLON. No.

In the first year, I think we probably would collect pretty near nothing, but in 1964, \$50 million.

Senator DOUGLAS. All right, let's start with 1964.

Wait a minute. We are talking about two things: First the amount we would collect in automatic data processing without withholding and, second, the amount we would collect by withholding.

Secretary DILLON. That is right.

Senator DOUGLAS. And you have said in the case of 1963, even under your automatic data processing you would not collect anything for that.

Would you collect \$900 million by withholding?

Secretary DILLON. That is correct.

Senator DOUGLAS. So withholding is superior to automatic data processing for 1963 by \$900 million?

Secretary DILLON. That is correct.

Senator DOUGLAS. In 1964, you just testified you estimated collection of \$50 million by ADP even if there was no growth in the economy as compared from 1963 to 1964 I think you would estimate that you would collect \$900 million by withholding so there is a net loss of \$850 million in that year, is it not?

Secretary DILLON. That would be approximately right.

Senator DOUGLAS. In 1965 it would go up to \$50 million, you would collect a hundred million as an estimate by automatic data processing, as compared to \$900 million, again with no growth factor or there would be a loss of \$800 million? Is that correct?

Secretary DILLON. That is right.

Senator DOUGLAS. In 1966 you would collect \$150 million by automatic data processing as compared to \$900 by withholding or the loss would be \$750 million.

In 1967 you would collect the full amount that automatic data processing could collect or \$200 million as compared to \$900 million by withholding, with a loss of \$700 million.

Senator WILLIAMS. Would the Senator yield?

Senator DOUGLAS. Just a minute, John, I want to do some addition here.

Secretary DILLON. I think this is about correct, although to be accurate, I think by the end you would get, say, \$240 to \$250 million. So the figure instead of being \$50 million would be \$60 million, which would be very minor but that is the difference.

Senator DOUGLAS. According to my arithmetic, therefore, during these intervening years until the end of 1967, you would lose by using automatic data processing alone instead of or as compared with withholding, a total of \$4 billion.

Secretary DILLON. I would say that is about right.

Senator DOUGLAS. Pardon me?

The gross collections

Secretary DILLON. No; that is right.

Senator DOUGLAS. That is correct.

Secretary DILLON. That is correct. It would be about that much. It is such a high figure.

Senator DOUGLAS. It may be to some members of this committee and of the financial community that \$4 billion does not amount to very much.

To me, this is a tremendous sum.

Secretary DILLON. It is a very big sum to the Treasury.

Senator DOUGLAS. And if we do not have withholding this would be a continuing loss, as well, would it not?

Secretary DILLON. At the rate of at least the \$700 million or \$650 million a year.

Senator DOUGLAS. And if the economy grows as we believe it will, the loss will be greater each year?

Secretary DILLON. That is correct.

Senator DOUGLAS. Well, I hope these facts can get out to the people.

I think the Members of the Senate, and the members of the press, have a responsibility to see that these statements get out to the Nation.

If they are incorrect, they should be challenged, but I believe them to be correct.

One final question I would like to ask now:

Would you again compare the amount of paperwork, the number of slips of paper, the costs, the number of accounts needed, and so forth, under automatic data processing with the administrative costs under withholding, Mr. Secretary?

Secretary DILLON. Well, under automatic data processing, assuming we reduced the reporting requirements to \$10 on interest, that would mean an additional 250 million information returns that would have to be filed with the Government by paying agents. And then we figure that by spending a reasonable amount of extra funds for an extra 3,000 agents, which would be about 50 percent more in money than the total cost to the Government of withholding, we would be able to collect the amount which I have mentioned earlier, which is about a third or a little less than a third of what we can collect under the withholding arrangement.

We can collect, in other words, under withholding three times as much for half the money.

We do not feel that this will be any great burden on reporting institutions either, because the only reporting institution that has given

us a detailed breakdown of costs has testified that, as far as it is concerned, withholding would increase their costs \$11,000, as compared to a profit of \$10 million.

So that is not a very big cost for the use of withholding.

Senator DOUGLAS. I have noticed a tremendous advertising campaign over the country, in local papers primarily, but sometimes in the national papers, and with brochures which are issued. Do you think that the costs of the institutions would be any greater than the cost of the advertising campaigns which they have launched to prevent this from going into effect?

Secretary DILLON. Considerably less.

(Laughter.)

Senator DOUGLAS. That is my general impression.

Secretary Dillon, I want to congratulate you on your testimony, and also I want to congratulate you on the way in which you can sit there with your staff at a discreet distance behind you, but seldom passing you up pieces of paper, and answering the most difficult questions with great composure and with accuracy, and not falling into the various traps that my astute colleagues at times have set for you.

(Laughter.)

Senator DOUGLAS. You have made a very remarkable showing, and I think the country is very fortunate to have a man with your ability as Secretary of the Treasury.

You still have not convinced me, I may say, on investment credit.

I reserve my right to differ with you on that point, and perhaps on other points as well.

But I think you have made a magnificent witness, and I congratulate you, and I think the country is very fortunate in having a man of your ability.

Now, at the conclusion of the session this morning, Mr. Chairman, I expressed the hope that during the period that the Secretary is in Rome, enjoying the pleasures of the springtime in Rome and the chestnut trees blooming there, that his staff, the staff of the joint committee, and the legal counsel for the Senate get together and begin drafting these technical amendments.

I am not certain as to the status in which this request of mine was left. But I hereby make the motion that our staff meet with the legal staff of the Treasury to complete some of these technical details.

Senator WILLIAMS. Mr. Chairman, I have no objection to expediting this, and I think the Secretary will agree that our committee has done everything we can to expedite these hearings.

We have held meetings in which representatives of industry have appeared during this past week, meetings which technically were illegal meetings because there was a sham filibuster in the Senate and there were objections to committees meeting.

We continued the committee meeting without any objections at all.

But if you wish to put a vote, now I will make a point of order there is no quorum present, and we would have to recess until we get a quorum, and, yet, I had hoped that we can finish this testimony now. I do not think that we should be put into a position of trying to vote with 4 members here to bind 17 members.

I have no objection to voting, but I would have to make a point of order if pressed at this time.

Senator DOUGLAS. May I ask my good friend from Delaware and he knows I have great respect for him—does the Senator from Delaware object to the staff's meeting?

Senator WILLIAMS. Certainly not.

Senator DOUGLAS. Does my good friend from Delaware not believe this will expedite action on the bill?

Senator WILLIAMS. You have asked for the committee to vote, and this cannot be done without a quorum present.

Senator DOUGLAS. Can we not have a gentleman's agreement?

Senator WILLIAMS. If the Senator from Illinois would join us as gentlemen, I think they would agree to the request as made.

Senator DOUGLAS. I do not know whether the Senator will let me join his club.

Senator WILLIAMS. Mr. Secretary, do you feel there has been any delaying action with regard to this bill?

Secretary DILLON. I feel that if we are to go ahead promptly the Treasury staff should be permitted to work closely with the committee staff in the next few days. I think all the Senator from Illinois was trying to assure himself of was that this would be permitted and that then we would be able to operate in this way so that we could be further along when the committee meets for executive session.

There is no implication that there has been any delay.

Senator WILLIAMS. That is the point.

The chairman is not here, and I do not think there has ever been an occasion when the chairman of the committee has ever hesitated to work with your staff, and it is my understanding that your staff and our staff are already working in conjunction with this bill.

Secretary DILLON. That is not correct.

The staff of the joint committee has not felt free, and Mr. Stam has not felt free to allow it to work with our staff until the testimony was completed. We hoped he would feel free and the committee would feel free to allow him to let us work together now that testimony has been concluded.

Senator WILLIAMS. After the testimony has been completed?

Secretary DILLON. Yes.

Senator GORE. Let us get free of that, if possible.

Senator DOUGLAS. I hope that the testimony may be completed this afternoon.

Senator WILLIAMS. I want it to be completed, but I do not think it is fair to leave the impression that the chairman of the committee is trying to——

Secretary DILLON. No.

Senator DOUGLAS. No; perish the thought.

Senator WILLIAMS (continuing). Is trying to hold back committee action.

I think you have had the utmost cooperation from the committee and of the staff.

Senator DOUGLAS. The Senator is sensitive on this. I will not attribute to him any Freudian sense of guilt on this matter. I will simply say this was not my intention. I merely asked that we get together in the future, and we hope the Senator will not throw any roadblocks.



Senator WILLIAMS. I have not thrown any roadblocks. I was here all through the Easter recess, and I do not know whether the Senator from Illinois was here or not.

Senator DOUGLASS. I merely suggested that the two staffs might get together.

I hope that what God has joined together man and caprice will not put asunder. [Laughter.]

Senator GORE. The Senator from Indiana. [Laughter.]

Senator HARRIS. Mr. Secretary, with regard to section 3, which relates to deductions for expenses incurred in an attempt to express an opinion or to affect the outcome of legislation, I introduced a bill on this, S. 467, and our attempts to obtain any type of expression of opinion from the Treasury have resulted in failure.

After two letters to which we did not have a reply and after several requests, we were informed that no expression of opinion would be given, plus the fact that in your testimony here the only expression by the Treasury Department is the one-word sentence in regard to section 3, "the Treasury is opposed to this substantial change in the law."

I wonder, before we go into executive session, whether I could have some elaboration on this point for the benefit of the committee, because several Senators have indicated to me they feel that something along this line is at least desirable, and that this is a substantial change in the law as interpreted prior to the Internal Revenue decision about 1959.

Secretary DILLON. I just want to make the record clear. The Internal Revenue did not change anything. There was a court decision which emphasized the prior rule.

Senator HARRIS. That is right.

Secretary DILLON. And which may have had some effect on the practice.

Now, the administration feeling on this is that they feel this is a very important substantive question.

There were no hearings on it whatsoever in the House. That has been corrected to the extent that there has been public testimony here.

But when this matter was put into the bill and passed in the House, there had been no hearings on the matter. We had not been permitted to make our public statement, and there had been no chance for those who were opposed to this provision to state their views.

Now, what it does is, for the first time, to allow the Government to pay some of the expenses of trying to influence legislation, which is not solely a revenue question. It is really a very deep policy question.

And the views we express are not just Treasury views. I do not think there are any fundamental dollar revenue aspects involved here as far as the provision passed by the House is concerned. We just felt that this was the type of thing that should be very thoroughly considered and should preferably not be included in an overall bill. If Congress wished to pass a bill of this nature, it would be better to consider it separately, pass it separately, and allow the President the privilege of considering his attitude on it separately.

Now, we did feel much more strongly about some of the provisions for deducting advertising expenditures and things of that nature, because that could lead to certain advertising which could be very controversial. It would lead into the question, Would advertising to

defeat right-to-work laws be deductible? Also, for instance, would advertising by liquor companies to defeat local options be deductible?

It would raise all sorts of highly emotional issues which, we thought, were undesirable and should not be raised. That is the reason why we have opposed this at this time.

We do not think that the way the law is operating now is really going to be any great handicap to anybody. The Internal Revenue Service is trying to work out each case on its merits. It has decided that some portion of the dues paid should not be deductible by those who paid them in only a relatively small number of cases involving national organizations. If the amount of lobbying runs 5 percent or less, the Service generally drops the matter as de minimis and makes no effort to make any part of the dues nondeductible.

There are institutions or groups which are formed for the specific purpose of opposing or promoting a particular law or particular type of legislation or where almost all their expenses are lobbying, and in those cases the claimed deductions would be substantial.

That is the general reasoning we have followed, and I have no objection at all to putting it forward.

We felt, in effect, this was breaking a precedent of not permitting the deduction of expenses to influence legislation which has been on the books for a long time and which we think generally is sound. Of course, enactment of section 3 would set up some serious preferences, because nonbusiness individuals who may be very interested in particular legislation could get no deductions for their appearances if the deductions should be limited to business organizations.

That was our general philosophy.

Senator HARTKE. I recognize the point about the emotional issues, but also it would affect such things as trying to encourage referendums for a bond issue for the building of civic improvements and things of that sort just as easily.

Secretary DILLON. Sure. It is very complex; it cuts across many matters.

Senator HARTKE. The Treasury Department does not have any special interest in doing anything to those people who consume liquor, I do not believe, and they permit the expenses of advertising for certain alcoholic beverage concerns as a business deduction, so I do not believe that we should insert emotional issues as an objection when there are certain things which can be put on an emotional basis upon almost any part of this bill.

I think probably the yachts and things of that sort would be emotional issues which have been inserted, too, as well as on the savings and loan thing, the aspect that this is a new tax, which is an emotional issue.

But the Boggs bill was reported favorably by the House, by the 86th Congress, after hearings there, and this is not—

Secretary DILLON. I do not think there were any hearings.

Senator HARTKE. Were there not hearings in the 86th Congress?

Secretary DILLON. No, it was reported without hearings.

Senator HARTKE. I am not trying to do anything without hearings; but I am trying to get an expression of opinion from the Treasury.

Let me ask you this. You speak about individuals as far as preference to corporate or business structures over individuals. This is true

in almost every type of appearance for a business; for example, if they appear before an administrative group, they are permitted to deduct this as a business expense.

Secretary DILLON. That is correct.

Senator HARTKE. But if an individual appears before an administrative group in regard to his own personal rights, this is not a deductible item.

So this is not a departure in this respect.

Secretary DILLON. No, except as it bears on legislation. There it is entering a new field.

Senator HARTKE. And the truth of it is there are legislative matters which can have as material an effect upon the outcome and the determination of a business as can an administrative decision or a lawsuit, and this is a discrimination placed upon the activities of groups or individuals and on a business basis which distinguishes between administrative expenses those expenses to effect an administrative decision, whether it be to effect an increase in rates before the Interstate Commerce Commission or to ask for special consideration with regard to the Tariff Commission, and all these matters are presently considered as deductible items, and provides that the businesses have a right to appear there.

All I wanted really for the record was some expression from the Treasury other than a blanket opposition.

Secretary DILLON. I would say our opposition is much stronger to broadening this to advertising than it is to the provisions in the House bill. But even those provisions, we thought, were unnecessary. There were no hearings there. We feel that on a matter as important as this there should be full hearings, public hearings, in each body, and a full chance for consideration.

Also, as I mentioned, I think that the administration feels that this is something that could be better presented separately so that the President could consider his position on it; it should be passed by the Congress separately from other legislation.

Senator HARTKE. But, as I understand the position of the administration, it is that they would like to have it eliminated and have no further consideration of it in any separate way or otherwise.

Secretary DILLON. No.

We would like to have it eliminated from this bill, and if the Congress then cares to enact it, the President would consider what he would like to do about it.

Senator HARTKE. In other words, we should not anticipate any separate initiative from the administration on this?

Secretary DILLON. Oh, not initiative, no; that is correct.

Senator HARTKE. One other matter, that of the investment credit. I read that the Treasury Department's reform in depreciation would be set forth about July 1.

Is it the opinion of the Treasury Department that the revision of the so-called schedule F, which is under way at the present time, is in reality a reform in depreciation?

Secretary DILLON. Most certainly it is an updating of the administrative procedures and it is a reform in the way those procedures are carried out, which is very significant.

It includes an updating in the lives of depreciable property and a significant reform in the administration of those procedures. But the main objective is to reduce to the maximum extent possible the individual judgment of revenue agents in different parts of the country and to replace that with an objective set of standards which will be the same the country over and which business will know will be the same, even if revenue agents change as time goes on.

I think that can be done, and I think that it will be of very great importance to business. Certainly from all our requests, our questionnaires, and so forth, to business, business finds this a very important change.

This has been one of their big bothers, although theoretically it should not have been. That part of it should not have any great revenue impact. But I would not call that a reform; I would call that simply carrying out the present law and bringing it up to date.

Senator HARRKE. I want to commend the Department for doing this. I think it is a remarkably difficult job, and it is work which needs to be done.

But I was fearful that maybe the Treasury Department, in view of its letter to the chairman of this committee, meant that it was a substitute for that which was described in the statement on page 6 of your letter of August 25, in which you said:

The Department is engaged in studies to determine the realism and adequacy of depreciation under present conditions looking to recommendations next year for whatever reforms may be needed in this area.

And I was wanting to know really whether this was intended to be a substitution for this statement or whether this was a change in policy by the Department.

Secretary DILLON. No.

We feel that through the reform that we can carry out here, particularly the administrative reform substituting more objective criteria, that we can achieve pretty much all the objectives that business has in mind for the administration of this law.

We are now just about ready to have final consultations with certain legal, accounting, and business groups on the type of changes that might be made. Our feeling is that we wanted to see fully what the reception of the law would be. It is our feeling that once business has a chance to see them and study them, the desire for any further drastic changes in the depreciation provisions will subside.

If that is not the case, and if we cannot answer all the problems, we are perfectly ready to and will consider any further changes in the law that may appear appropriate.

Senator HARRKE. Then I understand from that statement this is really in substance a change in the position taken by the Department in the statement by the Department last August to the chairman?

(The letter dated August 25, 1961, referred to above, was a Treasury report submitted to the chairman on S. 720 and four similar bills. Since the context of S. 720 was introduced by Senator Hartke on April 3, 1962, as an amendment intended to be proposed to H.R. 10650, it is appropriate to print below the full text of the letter:)

TREASURY DEPARTMENT,  
Washington, August 25, 1961.

Hon. HARRY F. BYRD,  
Chairman, Committee on Finance,  
New Senate Office Building, Washington, D.C.

MY DEAR MR. CHAIRMAN: This is in response to your request for the views of this Department on the following bills, each of which would provide accelerated depreciation deductions or similar additional allowances for investment under the income tax:

S. 2, "To assist small business and persons engaged in small business by allowing a deduction, for Federal income tax purposes, for additional investment in depreciable assets, inventory, and accounts receivable."

S. 378, "To amend the Internal Revenue Code of 1954 so as to permit the use of the new methods and rates of depreciation for used property."

S. 580, "To amend the Internal Revenue Code of 1954 so as to permit, for purposes of the depreciation deduction, taxpayers to specify, under certain conditions, the useful life of tangible personal property acquired after December 31, 1960, and for other purposes."

S. 715, "To amend the Internal Revenue Code of 1954 to permit amortization over a 60-month period of facilities to produce new industrial products derived from certain agricultural commodities."

S. 720, "To amend the Internal Revenue Code of 1954 for the purpose of stimulating economic growth and activity, providing additional jobs for the growing labor force, and permitting the replacement of obsolete and inefficient machinery and equipment by the allowance of reinvestment depreciation deductions."

S. 2 would allow business taxpayers a tax deduction for additional investment in depreciable assets, inventory, and accounts receivables, up to \$30,000 a year or 20 percent of the taxable income of the business, whichever is less.

This proposal is designed to provide tax-free reinvestment of business earnings up to specified amounts, in various types of business property, in order to supplement existing sources of business credit and equity capital and thus help finance business expansion from tax-free retained earnings.

It is estimated that S. 2 would reduce revenues by about \$2.5 billion annually. A considerable part of this estimated revenue loss would be attributable to the normal growth of inventory and accounts receivable throughout the economy.

While this proposal has been urged primarily as a form of tax assistance for small business, the bulk of the tax decrease involved would go to some 100,000 or the 10 percent of the total business population, chiefly corporate, in the middle and upper ranges of the business size scale.

An important part of the objective of the proposal to encourage investment would be met by the administration's investment tax credit proposal, tentatively approved by the House Ways and Means Committee in the form of a flat 8-percent tax credit on additional investments in machinery and equipment, including used property up to \$50,000 annually. While inventory and receivables are an important factor in the financing requirements of business, a prime element in increasing our productivity and efficiency is business machinery and equipment, investment in which from retained earnings or other sources will be effectively encouraged by the administration's investment credit. This stimulus to modernization, growth, and development of our productivity will also make it easier for business to finance increases in inventory and receivables without special tax deductions.

Whatever inadequacies may exist in our present financial structure for accommodating working capital needs of small business would better be remedied through reexamination of the Small Business Investment Company Act of 1958, the Small Business Administration loan program, and other aspects of our financial institutions rather than through the use of the tax system.

Deductions for increases in inventory and receivables are particularly susceptible to manipulation and abuse, through multiple entities, temporary purchases and liquidations around the end of the taxpayer's fiscal year, and other devices. While the bill contains intended safeguards against multiple benefits by affiliated corporate groups, this would deal with only one aspect of the abuse problem.

The treatment of alternating increases and decreases in inventory, receivables and other assets under the proposed deduction presents difficult problems of policy and administration. The bill S. 2 measures deductible increases only with reference to the beginning of the taxable year. Taxpayers could therefore deduct an increase in assets in one year, liquidate the next, and reaccumulate

with a further tax deduction the following year, thus cutting revenues without achieving net economic expansion. "Ratchet" provisions to limit benefits to net increases above the previous high of investment or recapture provisions to prevent unwarranted tax savings or outright abuses would be complex and only partially effective.

Under the circumstances, the Department is opposed to the enactment of S. 2. S. 378 would extend the liberalized depreciation methods for new assets adopted in 1954 to used property acquisitions after December 31, 1960, subject to a maximum limitation of \$50,000 a year (or an average of \$50,000 a year over a 5-year period).

This legislation is designed to correct what has been regarded by some as a discrimination against small business relying on used plant and equipment and against sellers or dealers in used machinery. The difference in treatment of new and used assets for depreciation purposes was partially dealt with by the adoption in 1958 of the additional first-year depreciation allowance under section 170. This provides an additional first-year deduction of 10 percent of the cost of acquisitions of tangible personal property, both new and used, with a service life of at least 4 years, up to \$10,000 a year (\$20,000 on a joint return).

It is estimated that the enactment of S. 378 would reduce revenues about \$75 million in the first year, increasing thereafter.

The recently announced decision of the House Ways and Means Committee approving extension of the proposed 8-percent investment credit to acquisitions of used machinery and equipment up to \$50,000 a year would, if enacted into law, meet the major objectives of S. 378.

Under the circumstances, it would seem inappropriate to adopt S. 378.

S. 580 would allow taxpayers to elect accelerated depreciation on "tangible personal property" (machinery and equipment but not real estate) based on a useful life selected by the taxpayer of not less than 5 years for new and 3 years for used property, using the straightline method and regular salvage estimates. Gain on sale of property subject to the faster writeoff would be taxed as ordinary income, to the extent the gain reflected the excess of the accelerated over regular straight line depreciation. No safeguards are provided under the bill against large-scale turnover of existing assets to bring them under the 3-year writeoff.

This proposal would be equivalent to a broad program of fast amortization. Assuming all taxpayers took advantage of the plan, the revenue losses would be about \$1 billion in the first full year, and increase to about \$4 or \$5 billion after 5 years.

The proposed 5-year amortization on machinery and equipment would apply to approximately the same area of investment covered by the administration's proposal for an investment credit, as tentatively approved by the Ways and Means Committee. It is believed that the investment credit would provide a more effective stimulus to modernization and expansion than the 5-year amortization approach under S. 580, for roughly the same revenue loss in the first year and at substantially less revenue cost for a considerable period thereafter.

Under the circumstances, the Department recommends against the enactment of S. 580.

S. 715 would provide accelerated amortization over a period of 60 months for facilities certified by the Secretary of Agriculture as needed for the production of new industrial products derived from one or more agricultural commodities. Gain on sale of facilities subject to the proposed accelerated amortization would be subject to ordinary income tax treatment to the extent attributable to the excess of the amortization deduction over ordinary depreciation, as provided in section 1238 of the Internal Revenue Code.

Five-year amortization has been proposed on a selective basis for various types of investments including saline water conversion facilities, urban renewal and rehabilitation outlays, civil defense protective facilities, plant investments in depressed areas, farm facilities, and various other types of construction which are important to the Nation's economy and its defense. In addition, accelerated depreciation has been urged for the railroad industry, textile manufacturing equipment, machine tools, and in other fields to alleviate economic difficulties and stimulate particular types of capital outlays. Important as all of these types of investment are, accelerated tax write-offs for any one type of outlay could not be adopted without establishing a precedent for similar tax treatment for others, including many not listed here.

The accelerated amortization program adopted during the Korean conflict and the period thereafter for defense facilities and atomic installations was termi-

nated at the end of 1950 in the recognition that this type of special tax treatment was not suitable in the peacetime tax structure. To reintroduce and broaden the use of rapid amortization would have substantial consequences for our tax system in terms of both loss of revenue and the distortion of the equitable distribution of the tax burden.

The investment credit recommended by the administration and tentatively approved by the Ways and Means Committee in the form of a flat 8 percent credit on machinery and equipment outlays generally would be of substantial assistance in the case of many business expenditures for new types of industrial production involving the processing of agricultural commodities. The related measure tentatively adopted by the Ways and Means Committee to disregard estimated salvage value up to 10 percent of the cost of new machinery acquisitions in computing depreciation would also afford benefit to the new types of industry which S. 715 is designed to assist.

In view of these considerations, the Department is opposed to the adoption of S. 715.

S. 720 would provide an additional allowance termed "a reinvestment depreciation deduction" which combines elements of depreciation based on replacement rather than historic costs and the allowance of accelerated depreciation.

In substance, this bill provides a reinvestment depreciation deduction equal to the difference between the original cost of depreciable assets retired during the year and their current replacement cost, provided the taxpayer actually reinvests the latter amount. Retirements and reinvestment would be measured in aggregates; there would be no requirement that the replacement assets be similar to those retired. Current replacement cost of an asset would be determined by multiplying the historic cost by the ratio of an appropriate plant and equipment price index in the current year to the index in the year the asset was acquired. The Secretary of the Treasury would be required to proclaim the index used for this purpose.

The reinvestment depreciation deduction would be subtracted from the recoverable basis of the new property. This would correspondingly reduce the amount of regular depreciation in the current and future years. In this respect, the plan is tantamount to accelerated depreciation, consisting of an initial allowance on new property measured by the difference between the historic cost and replacement value of the old.

The bill contains a number of special rules and features, such as ordinary income treatment on the portion of resale gain due to the reinvestment allowance, a 2-year carryover of unused reinvestment allowances, and rules for the treatment of nontaxable transfers, which would need attention in a more detailed analysis.

The operation of the reinvestment allowance may be simply illustrated as follows. Assume a taxpayer in 1961 retires a machine which cost \$1,000 in 1946, and spends \$2,000 on a new, improved model. Assume further that the price index determined by the Secretary of the Treasury is 100 for 1946 and 150 for 1961. The taxpayer would be allowed a reinvestment depreciation deduction of \$500 (\$1,000 times 150/100, less \$1,000). The depreciable basis of the new \$2,000 machine would then be reduced to \$1,500.

While this type of legislation in the past has variously been termed "retrospective correction for higher replacement costs" and "LIFO for fixed assets," one of its current objectives appears to be to stimulate growth, modernization, and the replacement of obsolete plant and equipment. In the view of the Department, the proposed investment tax incentive credit would better accomplish this purpose for a given amount of revenue effect.

It is estimated that S. 720 would involve very large revenue losses, ranging up to \$10 billion in 1961, and correspondingly large amounts in future years. Current revenue losses would taper off in the event prices leveled out for some time.

Benefits under S. 720 would vary depending on the firm's history and the length of life of assets. Large benefits would go to the utilities with long-lived assets due to the wider spread between acquisition and replacement costs. There would be little or no current benefit for new or recently established firms, and relatively little for the rapidly growing firm most of whose acquisitions were recent. The equity of this distribution might be justified in terms of the replacement cost theory, but it would not be fully consistent with incentive objectives.

S. 720 would introduce the principle of the use of index number adjustments for depreciation purposes. This would be complicated, difficult to administer, and a precedent for its further extension to other areas of the tax law, such as

the measurement of taxable gains. It would present problems of "trafficking" in old corporate assets to obtain a favorable tax posture for reinvestment in a new and different business.

The Department is engaged in studies to determine the realism and adequacy of depreciation under present conditions, looking to recommendations next year for whatever reforms may be needed in this area. It would be undesirable to adopt the drastic type of change in depreciation methods proposed in S. 720 prior to the completion of these studies.

Under the circumstances, the Department opposes the enactment of S. 720.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,  
*Assistant Secretary.*

Secretary DILLON. I think we found we could go a good deal further than we thought at that time in changing the method of operation of this depreciation law, and that these changes will meet a great many of the specific objections which have been filed by business.

You know, we had a very detailed questionnaire which was sent out to business under the preceding administration in which they listed the things that were wrong with the handling of depreciation and what should be done.

And we think one of the main things is that they all seemed to like what they considered to be the system in effect in Canada. I think that the type of reform that we can bring about here administratively will be able to give business most of the administrative benefits that they thought they saw in the Canadian system. In some respects it will be better than the Canadian system, because it will retain the right, which the Canadian system does not have, for companies to depreciate equipment faster than the guidelines provide if they so desire and can indicate that they really are replacing it faster.

Senator HARTKE. It is an unfair assumption on my part, then, that it is anticipated that these studies in the field of depreciation will be discontinued until such time as the determination can be made as to the effectiveness of the extension—I mean the revision of the so-called schedule F and the investment credit, providing the investment credit is enacted into law?

Is it an unfair assumption?

Secretary DILLON. I do not think that we feel the need for any further major changes, because we think this answers most of the problems.

It may be as a result of the publication of these new procedures and of the discussion of them with business, which will be carried on in the next 6 months, that it will become obvious that there are one or two additional things that need to be done.

If that is the case, we have no compunction against considering them—we are not drawing any line and saying, "Thus far and no further."

We will be glad to try to do anything else that is necessary and appropriate, because our major objective is to put American industry on an equivalent basis with its competitors overseas, to give it a fair basis of realistic depreciation, and to minimize and reduce to zero the feeling that it has had there has been uncertainty and harassment



in their relations with the Internal Revenue Service in this particular area.

Senator HARTKE. But there really will be no change as far as the practice is concerned?

Secretary DILLON. There will be a very real change as far as practice is concerned. There will be no change in the law, because the practice was largely based on Internal Revenue procedures which were just the way the law was being administered.

We think we can administer it in a much better fashion.

Senator HARTKE. I understand that. But within the limits of the regulation and the present statute there still will have to be an opinion which will often have to be on the basis of the revenue act in the field.

Secretary DILLON. No, this will be quite different. We will develop an objective standard here, based on figures, so that the opinion of the agent in the field will not be required except in cases that are exceptional, where a company feels that it is entitled to an even higher rate, and where their figures do not yet show that. In other words, where they haven't yet begun to replace equipment at a more rapid rate. There will be no individual right for agents indiscriminately to question or lower the rates—raise the lives—used by businesses.

Any such thing will be, as I say, in accordance with an objective table which will compare the total depreciation reserve of a company with its total depreciable assets.

Senator HARTKE. Then this is a substantial change not alone in a revision of the useful life tables but a revision in the regulations, is that true?

Secretary DILLON. Oh, very substantial.

Senator HARTKE. Now, in the field of—

Secretary DILLON. I would like to say that this has been outlined in some detail today publicly by the Under Secretary of the Treasury and copies of the statement on this will, of course, be available to all the members of the committee and may well be in the press. I would have made the statement myself if I had been at Hot Springs today. It was made by the Under Secretary in my place. We had something like a five- or six-page statement going into this in some detail so you will be able to get a full understanding of it.

Senator HARTKE. I will be looking forward to seeing it.

(The information referred to appears on p. 4382.)

Senator HARTKE. Under this investment credit though, isn't a deduction allowed whenever the project is completed and ready and eligible for depreciation?

Secretary DILLON. The credit is allowed when the item is placed in service.

Senator HARTKE. In service.

And this, in effect, will have those projects which require longer periods of time, maybe several years, requiring an investment of capital over a several-year period, will require them to wait until such time as this item is ready for use before any real value can be obtained, is that true?

Secretary DILLON. Under the law as passed by the House, that is true.

We have studied the question posed by that provision and we are openminded on it. There is a certain number of cases, very small

overall, where this problem would really apply, where the installation of equipment takes over a year, and it may be that some special provision should be written in to take care of this.

It will introduce a further complication in the bill and I think it is a question of weighing in Executive session whether that complication is worth the benefits that come out of it. But we have no firm position in opposition to this. We recognize the problem and we would be glad to discuss it at that time.

Senator HARTKE. I know this is one of those emotional questions, and I don't know how to keep it from being a little bit emotional but isn't it true that some corporations and some companies are going to receive windfalls as a result of this investment credit provision?

Secretary DILLON. Well, I think there is no windfall. Some people have said, because the House bill applies the credit to all equipment put in service after the first of the year, that that is a windfall.

The reason for doing that is that we felt we couldn't make any other recommendation or business would immediately have slowed up normal operations to wait for the date where they could take advantage of this credit.

But the chairman pointed out they had no particular basis for assuming it was going into effect. Certainly the controversy that this particular question has aroused, has deterred a certain amount of activity here, I doubt if there is any company that has done much so far this year in anticipation of this. So it might be that the committee would want to change the date.

However, just so it is perfectly well understood: This is not a new idea, this going back in dates. Exactly the same system was adopted by the Congress in 1964 when they approved the double declining balance system which was applicable only to new investment. At that time it was applied back to the beginning of the year, apparently without any debate or any comment. But this time apparently the same thing that everybody accepted that time without debate has caused considerable debate.

Senator HARTKE. In regard to the proposed tax credit, those industries which have short-lived equipment have certain advantages, is that true?

Secretary DILLON. Certainly, the tax credit is more advantageous for a short-lived piece of equipment, because you can get the tax credit each time you get a new piece of equipment, and the shorter that period the more often you get the credit. That is the reason why there has been a sliding scale put into effect so the full credit does not become applicable unless the property is going to be held for 8 years.

Certainly, it is beyond question that the credit is of more use, just by its nature, to a 10-year asset than it is to a 20-year asset, because in 20 years, you get two credits, because you would have replaced the equipment.

Senator HARTKE. And those industries which are in our so-called depressed areas or those areas which have economic hardships with the older established industries, they are thereby put at a further disadvantage in relation to these other industries which have the newer industries which have shorter-term equipment, for instance.

Secretary DILLON. I don't think that industries in distressed areas necessarily have long-lived equipment. I must say that the industry

in the United States which is probably most representative of all distressed areas in the United States, is the strongest proponent of the credit that I know. That is the coal industry.

Senator HARRIS. That is right.

Let me ask you also in regard to those industries of that type, they also have low income, isn't that true, they are in the low-income brackets.

Secretary DILLON. In the —

Senator HARRIS. In the depressed area, generally speaking.

Secretary DILLON. Generally speaking, they are and that is one reason why we have recommended that the House provisions be amended here so that this limitation put in at the last minute to allow the credit for only 25 percent of the company's taxes in any 1 year be increased, and put back to the 50-percent figure which was the figure until the last few days, when for revenue reasons it was reduced.

That difference between these two figures means nothing to a very profitable company, but it means a great deal to companies that are less profitable. So we think that is the first change that should be made. We have also, for that reason, suggested just yesterday, that there be a carryback provision as well as the carryforward provision so that when a company falls on hard times it could use the credit immediately instead of waiting for future profits.

Senator HARRIS. Both the institution of a revision of the schedule F and the investment credit both of these I think implicitly recognized that our— that for years our depreciation schedule has not kept up to the times and, therefore, changes were necessary. I would feel that would be the occasion for need for new legislation.

But also during this period we have had a period of rising prices and isn't it true that the investment credit really gives no consideration to the effect of the rise in prices?

Secretary DILLON. Not directly, and that, of course, has been a problem.

It is not as big a problem today as it was, because so much of our equipment now has been bought since 1950, and the big problem of price rises occurred before that.

It is very difficult to do anything that would be equitable regarding this price change problem except indirectly by an incentive to investment which is what the investment credit will give.

I don't believe, and I can explain at some length, if you are interested, that a direct method which would compensate for the price rise would be equitable or useful in the economy.

Senator HARRIS. I understand you have expressed that in regard to the bill which I have on reinvestment depreciation.

However, the reinvestment depreciation approach would take into consideration the rising prices.

Secretary DILLON. It would take into consideration the increase in prices.

Senator HARRIS. There are certain other objections you have to that.

Secretary DILLON. Yes.

Senator HARRIS. I would appreciate if you would have your staff prepare three or four examples where they would compare the effect of the tax credit and the reinvestment depreciation upon a plant which

has, say, a 15- to a 20-year equipment base, in other words, their equipment is 15 to 20 years old, and these companies also which are basically in a low-income bracket. I would like to have those if I could for the executive session.

Secretary DILLON. We will do that.

Senator HARTKE. That is all the questions I have.

Senator GORE. Senator from Minnesota.

Senator McCARTHY. Mr. Secretary, are there any questions that you have not been asked? [Laughter.]

Secretary DILLON. I would be glad to answer any that you put.

Senator McCARTHY. I have some questions with respect to a group in my State of grain dealers, who are interested in going into a new grain trade overseas. Most of their trade is trade which they are competing for, for the most part, with long-established grain cartels, and it is their judgment that if the provisions of the law now being proposed would apply to them they would probably either have their efforts pretty well stopped or they might even have to get out of the trade.

One of their proposals was that we might make an exception with regard to agricultural commodities.

We made some exceptions with regard to agricultural commodities in the domestic market, as you know.

I would like to ask whether the Treasury has considered this or whether before we get around to drafting the bill you would give us your thought to the question of whether there is some sufficient justification for it on the basis of the facts.

Secretary DILLON. We would be glad to give consideration to that. I knew of that testimony.

We do not have any particular suggestions now.

Certainly the export of our agricultural products is one of the most important trades we have, and is vitally important to us for balance of payments reasons, and we would not want to do anything that would hurt this important industry.

Senator McCARTHY. Along with that consideration is the possibility of using some other criteria than simply whether it is an underdeveloped country or an undeveloped country.

I would suggest consideration of whether or not there might be other distinctions and classifications that might be used.

Secretary DILLON. Yes.

Senator McCARTHY. A second question, Mr. Secretary:

Your testimony was that something over \$900 million in taxes on unreported interest income goes uncollected.

Now, it seems to me that much of this is in the income brackets of over \$10,000 or \$15,000, and that the Internal Revenue might have done a better job of collecting some of this interest.

What is the explanation? Is that hard to get at or why haven't they done a better job on it?

Secretary DILLON. Well, it is practically impossible, because the Internal Revenue Service, I imagine checks only 5 or 6 percent of the returns in the area of \$10,000 or \$15,000. Even when they do inspect a return it is very hard to pin down whether the individual may have had a savings bond or an account in a savings and loan institution or something of that nature. They ask him if he has any

interest he has not reported, and he says no. He may be perfectly honest in that because he has forgotten what he has in the savings and loan institution because it has just been laying there and growing.

So I think that is the reason that probably not more than half the interest that is credited to the individuals by savings and loan institutions is shown on tax returns, maybe not even that much.

So it is a very widespread mass form of nonpayment of taxes. I think, the mail that has come in, and the reaction we have had, shows that there has been a very real misunderstanding, and many in the country have not felt that this interest was subject to tax, since they had never thought of putting it on their tax returns.

Senator McCARTHY. It is sometimes hard to understand.

I had a case back home where they had been pursuing a barber on the grounds that his expense was reported on \$150 that he earned going out to the hospital to shave sick people, that he had overestimated his expenses.

I think they had one agent who spent 6 months pursuing this barber to recover \$10, I think, were the figures.

Secretary DILLON. That obviously is a waste of Internal Revenue effort.

What they do is to pick some tax returns at random, and then follow through a tax return even if it is a small amount just the same as if it was a large amount because I think that the theory is that that develops feeling that the tax laws are evenly enforced and has a certain deterrent effect.

Naturally, I am afraid, they put more of their emphasis on items in returns which involve expense deductions and things of that nature. I would think that that particular incident was probably a little overdone.

Senator McCARTHY. I suggested with regard to barbers that he stir them up. He suggested that they not use the cash registers.

The small commercial banks in my State report that something like 75 to 80 percent of all their savings accounts are accounts that are so small that they do not pay over \$10, \$15 a year in interest.

Now, what is the practical difficulty about granting an exemption and not applying withholding in cases of this kind?

Secretary DILLON. After a great deal of talk with experts of the ABA, I think they have come around to the conclusion, which was a little different from their earlier conclusion, that having an exclusion would probably cause them more trouble than it would no to have it.

Certainly, from the point of view of the Government and taxable income, there is no logical reason to exclude an account just because it happens to be a small amount of interest. In fact, in many cases, such savings accounts belong to people who have very considerable other income. They just put part of it in a savings bank or in a savings and loan institution, they may have several such accounts, and they may be subject to a tax even higher than 20 percent.

So the fact that income that accrues on the one account happens to be small does not mean that the tax rate on it will be small and, overall, it amounts to a very great deal in revenue.

As I have said, the ABA originally thought this was an important thing. But after study, with our experts and experts of the joint com-

mittee, I think they came to the conclusion that exclusion really was not very practical and, as you know, in their testimony before this committee they did not make any such recommendation.

Senator McCARRHY. Evidently their recommendations have not been wholly accepted by the independent bankers.

Secretary DILLON. It may be that certain banks feel differently because there was a lot of feeling in the banking community about that earlier, and I remember at the ABA convention last fall it was discussed at length. That is when we agreed that we would have some intensive technical discussions with representatives of various banks, and they would really try to see what this meant. When they looked into it, they decided actually it was not as helpful as one might think, in fact not helpful at all, although on the surface it sounds like, before you explore it, it might be a reasonable and sensible thing.

Senator McCARRHY. I think it would be true with the large banks which used automatic processing equipment.

Secretary DILLON. Well, the ABA represents them all, and this was their general view.

Senator McCARRHY. That is right.

The fact that we have used administrative difficulty as a justification for not having withholding on different kinds of income might be inconsistent, and it would not be unreasonable if we made a distinction within the same type of income.

Secretary DILLON. No; that is true. But they actually found that this would cause them more work, because then they would have to divide accounts, and if the account was \$10 and someone put in another dollar, it would be \$11, and it made a lot of extra work for them.

Senator McCARRHY. I understand.

One other question, Mr. Secretary: The original proposition with regard to investment credit was based on a different conception and purpose, was it not, when you recommended it in the House? The administration bill was to give credit for investment which was considered to be above and beyond what might be expected, this was a kind of economic shot in the arm, and you gave a different justification than what you gave for investment credit now.

Secretary DILLON. I do not think that the basic thought or justification is different. Certainly the impact is different.

The original concept was to give an investment credit which went up in amount, a moderate credit, which was quite similar to what we have now, of 6 percent for any investments that were over 50 percent of the depreciation base, and then 15 percent where the investment was over 100 percent.

That 15 percent was, of course, very high and a very strong incentive, and especially to companies that were growing rapidly.

There was a lot of objection in the hearings to this from accountants, in particular, and lawyers, who pointed out administrative problems with it.

Certainly our Internal Revenue Service agreed that it would be more difficult to administer than the present bill.

It had certain benefits that would give more help to those who invested more, but also the point was made that certain industries were just, by their nature, growth industries. Take the drug industry recently. It would, because it is a growth industry, get this very

exceptionally high rate, whereas industries which had been more depressed, such as the textile industry, would get very little benefit out of it.

So all and all, when it seemed that the great majority of the House committee felt this other approach was better, we had to agree that it was simpler from the point of view of general tax administration, and that although it might not give quite as strong a shot in the arm to growth in the country as the original proposal, it would still give a shot in the arm, and that is one of our our main objectives, one of the main things that we think will come from it.

So, therefore, we have accepted that change, and we now support the across-the-board concept.

Senator McCARRHY. Do you have an estimate as to how much of a stimulant to investment might result from this, how much more investment would you get within, say, a 5-year period than—

Secretary DILLON. I think one of the best examples was that which was given by a witness for a utility company here, who said that for every dollar that they received through reduction in taxes through the investment credit, they would invest \$2 of their own.

So, on that basis, you would have a stimulation of about \$4 billion or \$1,350 million from the credit, and \$2.7 billion from their own money, their own money that would go into investment that would otherwise not go.

I do not know whether it would be that big, but certainly we feel it would be substantial. I would say somewhere in the area of between \$2.5 and \$4 billion would be a fair guess.

Senator McCARRHY. My second question is, do you intend to continue this as a permanent part of the tax structure?

Secretary DILLON. We do feel it should be a permanent part of the tax structure to promote growth in investment, so we can gradually develop a better ratio of investment to GNP, and also, and very important, so that we can stay competitive with all the other industrial countries of the world, all of which give investment incentives of one form or another. We think this is the cheapest and the best and the most equitable way, and the least disturbing to general price levels.

Senator McCARRHY. One other question: What would be the Treasury's attitude—you need not answer that now—but suppose your original proposition or, perhaps, the 15-percent investment credit applied according to the provisions of the House bill, run only in those areas which are called distressed areas. It is a fact that the area redevelopment program is not proving itself adequate to really stimulate any kind of massive effort in these areas. There is a possibility that the investment credit will be of some significance and might encourage large corporations to establish plants in some of these areas.

Secretary DILLON. That is a very appealing concept, Senator.

The only problem with it is, and I think that is something that the committee would want to consider, and we all would—it raises the spectre of what has been called runaway plants. I think you would have in mind some new plant or new industry there rather than one that was taken away from some other area that needed it.

If it was possible so to limit it so that that would be the effect, I do not see that there would be any problem with it at all. But I think it would need some careful consideration for that reason.

Senator McCARRY. If this area redevelopment is generally in places where plants have just run away, I think we might just run them back in again.

I thank the Secretary.

Senator GORE. The Senator from Delaware.

Senator WILLIAMS. Mr. Secretary, in your prepared statement yesterday, I noticed you commented on eight sections of the bill, but you did not comment on sections 3, 5, 6, 7, 8, 9, 10, 11, 12, 17, 18, and 21.

Is the committee to assume that the Treasury Department makes no further recommendations in connection with these other sections or that you approve them as they are?

Secretary DILLON. No further substantive recommendations.

That does not mean that in executive session we will not discuss some of the testimony, or that we would not be prepared to accept technical amendments in these various areas, but we did not think they were important enough to raise at this time.

As I said right in the beginning of my statement, these changes which I listed were those that seemed to us to be clearly called for. I went on to say that undoubtedly further discussion in executive session will reveal other ways in which the bill can be improved.

Senator WILLIAMS. In the event that the committee did not accept any of your recommendations of yesterday or any of your earlier recommendations but decided to act on the bill as it was passed by the House of Representatives, would you go along with the bill as it passed the House of Representatives or do you think it should not pass unless it is modified?

Secretary DILLON. No; certainly, as the President said, and as I said in my earlier statement, the bill, as passed by the House of Representatives, is a good bill and goes a long way to achieve our objectives.

But I do think that the testimony certainly showed that there are areas in which this bill can and should be improved, and we would assume that that would be what happened.

Senator WILLIAMS. I just wondered in the event there were no changes made in the bill you would still endorse the bill as it passed the House of Representatives; is that correct?

Secretary DILLON. Rather than have no bill, that is correct. We might then come back another year and say that there were certain other changes in the tax code that could and should be made.

Senator WILLIAMS. I noticed in today's Washington Star, based upon a speech which was made down in Hot Springs, I think it is the one delivered for you, that they have announced that there is going to be a change in Bulletin F that will amount to one and a quarter billion dollars in tax reduction.

Secretary DILLON. No figure was given down there. That figure is probably just put in by the press because that is the figure we generally have been thinking about. As I saw the text of what I would have given out, there were no figures given at all.

Senator WILLIAMS. What would you estimate the savings to be?

Secretary DILLON. We do not estimate them as yet because we have not completed our work on the actual figures of shortened lives, but I would not be surprised if it came to that amount. But I just am not in a position to estimate.



Senator WILLIAMS. When will that schedule F be available that the committee could see it.

Secretary DILLON. It will be prepared, and we will be getting ready to issue it, we hope, by the end of June, and in no event later than the latter part of July. We are working as fast as we can.

The problem is that a great many of the individuals who have to work on it are also the same individuals who work on the present tax bill.

We do not have a large staff in the Treasury, and it depends somewhat on the course of events here.

Senator WILLIAMS. Do you consider that the modifications of schedule F, as being an important part of the administrations overall change in depreciation that is to be considered in connection with your investment credit proposals?

Secretary DILLON. I think it is a very important part. We have always talked about our proposals publicly as two-pronged proposals. I think that is the way I described it in my initial statement here on April 2. We will do what we can to modify and update Bulletin F. But then clearly that is not enough to make our provisions for depreciation competitive with those in other countries, not enough to give us the growth we need in new capital investment. So, therefore, we feel that further incentive is necessary, and that is the reason for the other prong, the investment credit prong.

Senator WILLIAMS. I am in complete agreement with the fact that you are making some changes in schedule F, and I congratulate you on that point. But I am wondering if it would not help the committee if we could get some idea as to what changes were being made in schedule F in order that we can make an appraisal of your other recommendations in connection with depreciation. They should be considered together, don't you think? They are a part of each other.

Secretary DILLON. What we have done—and where this figure, I think, came from—is we figured that if the same degree of reduction that was applied in the case of textiles was applied across the board, we would come out with a figure of about this billion and a quarter, and I think that is about as far as we will be able to go for some time.

I do not think that is at all out of line. I think it is a pretty fair estimate.

Senator WILLIAMS. Perhaps you misunderstood me. I did not mean to get the estimate necessarily.

Secretary DILLON. No.

Senator WILLIAMS. I just wondered if it would not help the committee to have, if we could see, schedule F being revised so we can consider it, because I am sure that in making your recommendation for a revision you took into consideration your recommended investment credit.

Secretary DILLON. That is right.

Senator WILLIAMS. And as we consider the investment credit or any change in depreciation, we likewise should take into consideration what changes may be contemplated or maybe are going to made in schedule F.

Secretary DILLON. We did not take the investment credit at all into account in the revisions in Bulletin F. We felt in the changes in Bul-

letin if we should go the maximum way possible to bring lives up to date, so that lives would reflect the current situation.

What was mentioned today and what you have seen, was the statement I was going to make myself, which Mr. Fowler made for me, and of which copies, of course, will be available for the committee. This is a rather detailed description, of what we are planning in the way of administrative revisions, which will give much greater certainty to the depreciation process, and which will remove the necessity for argument with individual agents. We think it is very important and a major change, but it has nothing to do with the investment credit.

Having done that, and having looked at all the facts we have got, and the studies of engineers, it is perfectly clear that whatever the change in lives that we can make, will not be enough to make our depreciation practices fully competitive with or equal to those of foreign countries. I submitted some tables which showed that in my original testimony, and that is why we asked for the investment credit.

Certainly you will have available this statement which was made in my name today. One of the purposes for making that was not only to assure industry that, contrary to some of the rumors that had been going around, we were still working hard at this, but also to get into the public realm the general lines of this change so that the committee would have it when they were considering this bill.

It is a rather detailed description, and I think it will be available. (The statement referred to follows:)

[Delivered by Under Secretary of the Treasury Henry H. Fowler]

EXCERPT FROM REMARKS OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY, BEFORE THE BUSINESS COUNCIL, HOT SPRINGS, VA., MAY 11, 1902

The administration's program of depreciation reform involves two aspects -- the investment credit and the revision, by administrative action, of depreciation guidelines.

There is general agreement in this country today concerning the urgent need to liberalize our tax treatment of depreciation to put it on a realistic basis. The administration clearly recognized this need from its earliest days and, building on studies initiated by my predecessor, Secretary Anderson, the Treasury has moved ahead as rapidly as possible with a thoroughgoing revision of our administrative guidelines for depreciation. Our work is now in its final stages and we expect to announce the new guidelines late next month or in July at the latest.

The new suggested depreciable lives for the assets used by American industry will be significantly shorter, on the average, than those now prescribed by Internal Revenue. In addition, and equally important, the new guidelines and the standards used in their application will be designed to achieve three major objectives:

First, simplicity—for the taxpayer and the tax administrators.

Second, objectivity—to minimize controversy about depreciation schedules.

Third, uniformity—to assure evenhanded application of the new rules to all businesses in similar circumstances, regardless of their location or which revenue agent they deal with.

I do not need to spell out for this audience the long history of disputes between the Government and business taxpayers concerning proper determination of depreciable lives. These disputes, which frequently have been prolonged and sometimes have required resort to the courts, were in large part made inevitable by the fact that Internal Revenue agents have had to use as their guide for depreciation allowances a bulletin published 20 years ago and never since modified.

Our new guidelines, and the rulings which will spell out the manner in which they are to be applied, are designed to bring to an end this debate, paperwork, and controversy.

The new guideline lives will in the vast majority of cases be significantly shorter than those set forth in Bulletin F. In no case will they be longer. Because many firms are already following faster depreciation schedules than those set forth in Bulletin F, the reduction from the lives now actually in use will, of course, be less than the reduction from Bulletin F standards. But for a substantial majority of taxpayers, use of the new guideline lives will result in increased depreciation allowances.

All taxpayers—let me repeat that—all taxpayers will, as a matter of right, and without question by any revenue agent, be permitted to use the new depreciation timetables in preparing their tax returns for the current year. The new guidelines will, of course, apply to machinery and equipment already in use as well as assets acquired subsequently.

The fundamental concept which underlies our depreciation revision is a belief that depreciation should be realistic. Our new guidelines are rooted in reality: existing and prospective rates of change in technology, in economic obsolescence, and in industry replacement practices.

But the new guidelines and rulings will seek to achieve more than a mere recognition of present-day realities. They will be designed to make sure that our tax standards do not constitute a barrier against movement toward even more rapid replacement policies on the part of industry.

Any business that has already demonstrated the appropriateness of its use of depreciable lives which are shorter than those set forth in the new guidelines, will be allowed to continue to use them. Internal Revenue will not challenge these depreciation deductions unless—by an objective, arithmetical standard, which will be spelled out in the Revenue ruling—there is a clear and convincing basis for such adjustment. This standard we call the reserve ratio and it will be based on the relationship of depreciation reserves to depreciable assets.

The use of such an objective standard is, of course, one of the most significant of the many meaningful changes we are making. As long as the depreciation reserves of a business do not become inordinately high in comparison to assets, the lives used by the business will not be subject to challenge at any time. Whether the reserves become unreasonably high will be easily ascertainable from tables which take into account the method of depreciation being used by the business and the rate of growth of its depreciable assets. The tables will provide for flexibility, a range of allowable fluctuations in depreciation reserves. The ratio of depreciation reserves to depreciable assets will be considered too high only after actual replacement practices have lagged substantially behind the depreciable lives being used for tax purposes. How high is too high? This also will be spelled out in the ruling.

For a business which shifts its depreciation timetables only to, but not below, the new guideline standards, a long period of time will be allowed before use of the guidelines will be challenged. Only if its depreciation reserve ratio proves it is not, in fact, replacing equipment as rapidly as it claims for tax purposes, will any question be raised by Internal Revenue. If a business can demonstrate that it is moving toward replacement practices in keeping with its use of the new guidelines, it may be allowed the length of an entire replacement cycle to actually reach that schedule. The fact that such a shift toward more rapid replacement policy is underway will have to be demonstrated, however, within a few years.

For those who wish to move for the first time below the new guidelines, or to reduce further an already below-guideline schedule, a look at the current depreciation reserve ratio will indicate immediately whether Internal Revenue might question this change on audit. In some such cases, a move toward shorter depreciable lives may nevertheless be permitted, despite the fact that the reserve ratio test would seem to indicate the shift is not warranted. Such a decision would, of course, be a matter of judgment on the part of the Internal Revenue Service, although certain additional criteria for exceptional treatment will be developed. But note that our one probable resort to standards other than those specified in the rulings can work only in favor of the taxpayer.

We believe that our new guidelines and rulings will greatly diminish the area of dispute between taxpayers and the Government over depreciation.

But this is not all. In the future, whenever application of the reserve ratio best indicates that a business should be shifted to the use of longer depreciable lives, there will be no penalty attached. The lives will be lengthened only to

correspond to the actual replacement practices of that business. Penalty rates will become only an unpleasant memory.

Our new depreciation guidelines will also be vastly simpler than those set forth in Bulletin F. In place of the more than 5,000 individual items of plant and equipment presently listed in Bulletin F, there will be substituted broad categories of assets for which an average life will be prescribed. Taxpayers may, if they wish, shift their own depreciation accounts to conform to the categories set forth in the new guidelines, but they will not be required to do this. So long as the taxpayer's overall depreciation account is in conformity with the guideline life established for that class of assets, the individual item lives used by the taxpayer will remain unchallenged.

This move to a broad category approach to depreciation will also, we believe, eliminate controversy between Internal Revenue and business taxpayers. The class approach we are working on is designed for simplicity. For most industries, a single class life will be established covering all machinery and equipment used in production. Items in general use, such as office equipment and furnishings, automobiles and trucks, will be covered in separate guideline classes to be used by all industries.

Buildings are a special case. As you are aware, the tax bill now pending before the Congress contains a section providing for correct tax treatment, as ordinary income, of gains realized on the sale of depreciable machinery and equipment. By closing the existing loophole in taxation of these gains, the legislation provides the safeguards necessary to permit our planned shift to more liberal and flexible treatment of depreciation of such property. But the legislation does not, at present, contain a similar provision applicable to buildings. I would be less than candid, therefore, if I did not tell you that we are not now contemplating a revision of Bulletin F so far as buildings are concerned. If, however, the Congress enacts legislation closing existing loopholes in the tax treatment of depreciable real estate, Bulletin F revisions covering buildings will follow.

Our depreciation revision as a whole will, indeed be meaningful to American industry and to the entire American economy. Can anyone any longer doubt this?

Depreciation revision has proved to be a monumental task—requiring long hours of work over a period of many months on the part of the most skilled economists, lawyers, engineers, and accountants at the command of the Treasury and the Internal Revenue Service. It also, as many of you know at first hand, is requiring numberless consultations with industry technicians and management.

But we will not consider the job done when we have published our new guidelines and rulings. We know that in such an enormous undertaking, some errors of fact or judgment are perhaps inevitable, and we will be responsive to industries or taxpayers who demonstrate the existence of such errors.

In addition, depreciation reform is, almost by definition, a job which is never done once and for all. These new standards will indeed, and for the first time, take into account not only past but anticipated obsolescence. But what about the technological breakthroughs which lie just beyond the ones we can now glimpse over the horizon. We do not know what they will be, but we do know that they will be. Periodic review and revision of our guidelines will, therefore, be essential if our depreciation policies are to keep pace with the changing world. Such review and revision is planned, for we must never again allow our tax practices to fall behind our industrial practices.

Senator WILLIAMS. I want it clear that I am not finding fault with the statement, and I am glad it has been issued, and I am glad we are that near getting a revision of Schedule F, and I agree fully that regardless of what action the committee may decide to take on investment credit it is important that Schedule F be modernized.

Secretary DILLON. Right.

Senator WILLIAMS. But I think it would be helpful, it would help all of us in making our determination on revision of this if we could see that revision as at early a date as possible.

Secretary DILLON. We are not trying to hide anything.

Senator WILLIAMS. I know you are not.

Secretary DILLON. We just do not have it ready.

Senator WILLIAMS. I just wonder when you might have it ready.

Secretary DILLON. I said in the latter part of June or if we are delayed sometime in July.

Senator WILLIAMS. As I understand it, the administration does not approve of the section of the bill which was put in by the House, the purpose of which was to redefine the manner in which lobbying expenses can be deducted; is that correct?

Secretary DILLON. We do not approve of that section which, for the first time, by law states that a portion of lobbying expenses can be deducted.

Senator WILLIAMS. Now, if that section were deleted, then under existing law, how would you define lobbying expenses as being deductible.

Secretary DILLON. Lobbying expenses under existing law are not deductible.

Senator WILLIAMS. None whatever?

Secretary DILLON. None whatever.

Senator WILLIAMS. I noticed an article which appeared in the Washington Post under date of April 2, and I am quoting from this article:

The Kennedy administration has lined up, at little cost, an array of high-priced talent to help promote tariff-cutting legislation.

Three executives, borrowed from industry, are devoting full time to the enlistment of public support for the controversial trade expansion program. They are being paid by their private employers while working at the Executive Office Building, next to the White House.

It went on to say that it is not costing the Government any money.

Now, would the employers of those men who are devoting their time to lobbying to this extent be in a position to deduct their salaries as a business expense under existing law?

Secretary DILLON. If they are full-time—

Senator WILLIAMS. Salaries.

Secretary DILLON. If their full time was clearly devoted to lobbying, I think there might be some doubt about that. I just do not know.

Senator WILLIAMS. In this instance it described these employees, and it said they were setting up offices, adjoining offices, next to the White House, and apparently they would not be devoting much time to their businesses.

Now, this happens to be a program with which I am inclined to be in agreement, and all that. But the fact that we are in agreement with or not in agreement would not change that.

Secretary DILLON. No, it should not change that at all. I am not sure of the accuracy of that story. But certainly I would think that any businessman who spent his full time lobbying, his salary would not be deductible, no matter what he was lobbying for.

Senator WILLIAMS. And you would suggest that the salaries of these men, while they are in this official capacity, even though paid by the company, would not be deducted as an expense item; is that correct?

Secretary DILLON. I am not sure there are any such people, and I do not know what the facts are. But certainly the Internal Revenue

would look at it in accordance with the law, and it should. There is not any kind of good lobbying which is different from bad lobbying, so I can see no real problem there.

Senator WILLIAMS. Just for your information, I will put the article as it appeared in the Post in the record, and would you submit to the committee later a report as to whether or not the article is correct and, if so, just how it would be interpreted so that we will know in similar circumstances the manner in which that would be taken care of.

Secretary DILLON. It may be that these individuals are not engaged in lobbying. The question of deductibility is primarily a question of what is "lobbying."

"Lobbying" is, by private individuals or companies or organizations, providing information, coming up here, talking to committees, talking to Members of Congress, and so forth. I would be glad to make a study of this, and we will see if these people really were lobbying. I would doubt it very much, but I will be glad to answer your question. (The article referred to follows:)

[From the Washington (D.C.) Post, Apr. 2, 1962]

#### TARIFF-CUT PROMOTION TEAM CHOSEN

(By Frank Cormler)

The Kennedy administration has lined up, at little cost, an array of high-priced talent to help promote tariff-cutting legislation.

Three executives, borrowed from industry, are devoting full time to the enlistment of public support for the controversial trade expansion program. They are being paid by their private employers while working at the Executive Office Building, next to the White House.

In addition, four public relations firms are doing volunteer work, without pay, from the Government. Some of these firms, located in New York, Chicago, New Orleans, and San Francisco, have client corporations which favor the measure.

Carl Levin, a vice president of Schenley Industries, Inc., is director of the operation. He said yesterday in an interview that his office has no official designation.

The trade bill is one of the most complex items awaiting action at the current session of Congress. It would authorize reciprocal 50-percent tariff cuts with the European Common Market. Also, it would allow the gradual elimination of tariffs on a limited number of industrial goods.

Senator WILLIAMS. Do I understand that industry, perhaps, could still even under existing law deduct the expenses of their employees engaged in promoting or opposing pending legislation as long as they do not come before Members of Congress, but just—

Secretary DILLON. Not if they are engaged in lobbying. As you know, during the war, and in past times, there have been people who have worked for the Government for nothing, and who received compensation from their companies. As a matter of policy now that is not done anymore.

Senator WILLIAMS. Of course, this article, which I have put in the record, clearly states it is for the promotion of the President's tariff proposal.

Secretary DILLON. Yes. I do not believe everything I read in the newspapers, but I will be glad to look into this and give you a full answer.

Senator McCARTHY. If the Senator will yield to me, I have a pertinent question. Is there any way in which we can estimate whether the expenses of junior executives who instead of going to the ocean

or the mountains spend all their vacations working in the campaign headquarters?

Secretary DILLON. No, not that I know of. I think they would be allowed to use their vacation any way they wanted.

Senator McCARTHY. They might even lobby during their vacation.

Senator WILLIAMS. The reason the Senator from -----

Secretary DILLON. It is a little abstruse for me.

Senator GORE. It is a little date in the day. [Laughter.]

Senator WILLIAMS. The reason I raised that question in all seriousness is, I think, that we hear a lot about lobbying, and I think we sometimes fail to recognize that our Government was set up to operate on a system of lobbying.

I mean, now in Russia the people who disagree with the legislative program do not petition their people. Here people have a right to petition their Government.

Secretary DILLON. We are all for that. We are not against lobbying. We think lobbying is fine, the more of it the better, because then the representatives of the people know what the country wants. We are only saying that the Government should not pay for it.

Senator WILLIAMS. Perhaps they should not, but I think in many of these matters of legislative programs, for instance, this tax bill, we have before us, that vitally affects the interests of business groups, I think they very properly come before us and very properly employ talent to present their cases. It is constructive both from our standpoint as Members of Congress and from the standpoint of the administration, and I am sure you agree with that.

Secretary DILLON. And they deduct their expenses quite properly. That is not lobbying. What they do is to go out and hire a lawyer, quite properly, to study a bill, and to advise them as to what the effect of the bill is, and what all their problems would be with it. He sends them a big bill, and they pay it, and it is deductible.

The only thing we are talking about as lobbying is you using that information to come down here and try to influence Congress.

Senator WILLIAMS. I am just trying to get it clear, and that is the reason I raised the point of these individuals here because, as I understand it, their purpose was to promote the passage of the trade act, and that is the way it was described.

Secretary DILLON. We will look into this particular thing and give you a legal memorandum on it.

(The legal memorandum referred to is to be submitted directly to Senator Williams.)

Senator WILLIAMS. I am not objecting to what they are trying to do, and I may well be supporting their objective. But that is immaterial. Whether the administration or I agree with what they do or disagree should in no way influence the deductibility.

Secretary DILLON. You are absolutely right.

Senator WILLIAMS. Assuming that this change in Schedule F amounts to \$1¼ billion savings in 1962, and I might say I am in favor of a change in Schedule F, but the adoption of the investment credit is \$1.4 billion, I understand, and that would be about a \$2.6 billion reduction in taxes for the American corporations in this year, if the two proposals are put into effect; is that correct?

Secretary DILLON. If they are put into effect as you describe them, that would be the end result.

But we do expect that as a result of that, there would be a substantial increase in investment and in business and that, in turn, would increase the tax receipts from American business.

Senator WILLIAMS. In years to come?

Secretary DILLON. No; this year. Actually we had expected that the investment credit might be enacted somewhat earlier and with somewhat less controversy, so I think that we will not get as much stimulation this particular year out of it as we might have under other circumstances.

Senator WILLIAMS. But the combined effect of the two would be about about \$2.6 billion this year?

Secretary DILLON. That is the gross effect.

Senator WILLIAMS. The gross?

Secretary DILLON. Yes. I mean, you can take the answer, for instance, of the United States Steel Co., which said that every penny they got in extra money they would immediately use to invest in further modernization, and that is certainly true in many businesses.

So I think a great part of this would immediately and very rapidly go back into the business flow. Whether it would this calendar year or not may be questionable, because the further along we get in the year the less likely there is to be time for companies to change their plans and to make orders and to get those orders delivered.

So I think you are quite right in thinking that probably there would be less reduction in revenue cost than we thought originally.

Senator WILLIAMS. And the theory behind this recommendation, as I got it, is that it would accelerate the economy and thereby benefit all the people as a whole.

Secretary DILLON. It most certainly would.

Senator WILLIAMS. You would not call this the trickle down theory, would you?

Secretary DILLON. No, not at all. That is not the idea at all. This would by new orders accelerate the economy and put more people to work, and the general result would be exactly the same as would be achieved by increasing the demand for consumer goods. You increase the demand for any kind of goods and you increase business. This just increases the demand for one particular kind of goods.

Senator WILLIAMS. In other words, the benefits would trickle down to all the people.

Senator GORE. I think it is a little late in the day for this kind of a needle. [Laughter.]

Senator WILLIAMS. I just thought we were establishing the fact that this would not be kept for the benefit of just the group that got the tax reduction but would go to all the people.

Secretary DILLON. Certainly, if that is the question. It certainly would not be a benefit just for business.

Senator WILLIAMS. However you put it. It would trickle down.

Secretary DILLON. The money would be used for salaries and further employment and consumption, and it would generally help the economy and increase our gross national product by several billions of dollars more than the amount of the credit.



SENATOR WILLIAMS. Whether you call it trickles down or what it is:

SECRETARY DILLON. It stimulates the economy and would reduce unemployment.

SENATOR CLARK. You would not call it percolate up, would you?

SENATOR WILLIAMS. Well, no, because we do not start at the bottom. We start with this, \$2.6 billion which would be put in the American industry and then we will skip the words trickles down and suppose we say seep.

SENATOR MCCARTHY. The worst thing about it, John, is that you are sustaining Karl Marx' criticism of the capitalistic system; is that right, Mr. Secretary? [Laughter.]

SENATOR WILLIAMS. Mr. Secretary, many of the questions which I intended to ask have been asked, and I expect a couple of times. I am very much interested in section 13, but I think many of those points have been covered, and I am not going to belabor them here now.

But as I understand it, one of the provisions of this bill was to break up the so-called tax havens.

SECRETARY DILLON. Yes. That was one of the major objectives.

SENATOR WILLIAMS. That was your objective.

SECRETARY DILLON. And it has been all along.

SENATOR WILLIAMS. I just saw your recommendations yesterday for the first time and I have not had a chance really to analyze them yet but, as I understand it, they exempted from any provisions of the bill the Commonwealth of Puerto Rico, the Virgin Islands or other possessions; is that correct?

SECRETARY DILLON. Puerto Rico and the Virgin Islands would be exempted from the provisions of sections 13 and 16.

SENATOR WILLIAMS. Sections 13 and 16 is what I mean.

Does that mean that the administration considers that there are no tax haven benefits in these areas presently under existing law?

SECRETARY DILLON. There are none in Puerto Rico as of the moment, and the Puerto Rican Government is resolutely opposed to the establishment of Puerto Rico as a tax haven. I think that this exemption could be so drawn, with the full cooperation of the Puerto Rican Government, that it would apply only to manufacturing in Puerto Rico, and to hotels in Puerto Rico, as they are interested in the tourist business. So there would not be any tax haven effect.

We are very conscious of that, and it is not our idea to open up any tax haven possibility there, and we have discussed this with the Puerto Rican Government, and they are in full accord with this objective, and there are not any tax haven operations there now.

SENATOR WILLIAMS. I am not passing any comment on it.

SECRETARY DILLON. I really wanted to make those facts clear in case they would be misunderstood.

SENATOR WILLIAMS. Would what you say be applicable to the Virgin Islands, as well?

SECRETARY DILLON. I think it would in general be applicable there as well. Certainly there is willingness to cooperate. We would draw the law in the same way so that it would not make it practical or possible to have a tax haven there.

Senator WILLIAMS. Is it your intention, when you said you would exclude them, that it would be drawn in such a way that it would not make it possible?

Secretary DILLON. Yes. It would be only for manufacturing operations and hotels and things of that nature, so they were treated as part of the United States, which they are.

Senator WILLIAMS. I noticed the other day again a newspaper story, but I checked it further and found it was correct, that in the islands they had granted the Harvey Aluminum Co. tax exemption or rebate for several years.

I just wondered under what circumstances they could do that now because apparently part of the manufacturing facilities will be conducted in the islands but, as I understand it, the finished products are being moved over to the mainland and processed further, and I just wondered if that is something which needs examination or are you familiar with that?

Secretary DILLON. We are not familiar with that particular thing, but there is a problem with Puerto Rico which we have been working on over the past year or two, and I think we are coming to a satisfactory conclusion.

If something is made in Puerto Rico and then shipped to the United States and further processed or sold by an integrated company, we do not want to tax the fair proportion of the profit that is made in Puerto Rico, but neither do we want to allow the company to transfer to Puerto Rico some of the profit that really inures to the operation in the United States.

So there is a valuation problem when those sales or transfers are made, which has been in existence for some time. We do think we are fully on top of it, and that it is no longer a serious problem. But it is a question of valuation which we have to do separately in each case, depending on the industry.

Senator WILLIAMS. Well, if I recall correctly, I think that situation was in the Virgin Islands, rather than in Puerto Rico, but the same thing is true.

Secretary DILLON. The big advantage here, as compared to the foreign operations is that we have the full cooperation of the Puerto Rican government and the government of the Virgin Islands. We know what the problem is on all sides, and we have all the figures, which is just what we do not have when dealing with tax havens abroad.

Senator WILLIAMS. I understood in this particular case they are guaranteed a refund of all Federal income tax liability for, I believe it was, 14 years.

Secretary DILLON. It might well be. Puerto Rico collects its own taxes and uses them locally rather than sending them to the United States. I am not familiar with our tax arrangements with the Virgin Islands; it may well be the same.

I can well imagine that they might feel it was to their advantage to give special tax rebates to get large industry established which would mean employment and funds and so forth.

This is certainly important in the Virgin Islands, in an area so small that if a big investment like this aluminum one went through,

there probably would not be much room for any other big company, because there are literally just a very few acres on each island.

Senator WILLIAMS. But I would appreciate it if you would check into that particular case, so that when we go into executive session we will have that before us, the benefit of that experience.

Secretary DILLON. I am informed the Virgin Island law permits rebates of their taxes to certain companies under a statute that was enacted by the Congress of the United States about 2 years ago which is, I suppose, for the purpose of helping development of this small possession of ours, and gives this special authority.

Senator WILLIAMS. Yes.

I was not questioning the legality, all of these things were being done under the permission of laws which were enacted.

Secretary DILLON. Apparently it is a new law which Congress just passed for this purpose.

Senator WILLIAMS. Sometimes new laws open loopholes even wider. We tried to close what we thought at that time were some of the loopholes, and maybe this does not need closing, but this particular point was left open.

I do not say that it is wrong but I wish you would study it and report.

Secretary DILLON. We will be glad to get a full report.

Senator WILLIAMS. If I recall correctly, that was a provision which I was sponsoring to close a loophole, but I think we should examine it further, and I would like to have a detailed report. I raise it for our information later.

(The report referred to follows:)

MAY 17, 1962.

Hon. JOHN J. WILLIAMS,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR WILLIAMS: This is in response to your question at the hearings Friday, May 11, 1962, on whether the Virgin Islands could be used as a tax haven. You were concerned in particular about Harvey Alumina Virgin Islands, Inc., a Virgin Islands corporation which is a wholly owned subsidiary of Harvey Aluminum, a domestic corporation. The subsidiary has entered a contract with the Virgin Islands under which the inducements, such as free land, and exemption from real estate tax, commonly offered by local governments in the United States are granted. One of the additional inducements granted by the Virgin Islands is a subsidy based on income tax liability.

In general, the Virgin Islands taxes corporations created in the Virgin Islands at full Internal Revenue Code rates on the income from all sources. Under section 934, added in 1960, however, the Virgin Islands may grant subsidies based on the tax liability of a Virgin Islands corporation 80 percent of whose gross income is from sources within the Virgin Islands and 50 percent of whose gross income is from the active conduct of a trade or business in the Virgin Islands. Although section 934 in itself would not preclude all tax haven operations, Virgin Islands law provides that the subsidy based on income tax liability can be granted only with respect to income from the construction, ownership, or operation of new housing projects, factory buildings or hotels. In the case of the Harvey Aluminum subsidiary a nontaxable subsidy equal to 75 percent of the income tax liability over a period of 16 years is granted on the condition that the subsidiary construct and operate a plant costing \$15 million and produce at 50,000 tons of alumina from bauxite ore.

Such substantial production is not considered a tax-haven operation in the case of foreign countries even though the country in which the production takes place grants special write-offs, or reduced rates. Such operations in foreign countries would continue to obtain deferral under H.R. 10650. The Virgin Islands incentive program is comparable to those provided by many foreign countries.

A problem will exist, however, in making certain that the prices paid by the domestic parent corporation to the subsidiary for alumina to be further processed in the United States will not shift to the Virgin Islands income which is properly attributable to the United States. This problem, just as in the case of transactions between other related domestic and related foreign corporations, will be dealt with under the amendments to section 482 made by section 6 of the bill. The Virgin Islands government cooperates completely in providing the necessary information.

Sincerely yours,

(Signed) STANLEY S. SURREY,  
*Assistant Secretary.*

Senator WILLIAMS. Does the Defense Department and the Department of Commerce endorse the provisions of the bill as they stand?

Secretary DILLON. I think they support the Treasury position. There never has been any problem that I know of with the Defense Department. I do not know that they have any particular interest in it.

The Department of Commerce, so far as I know, fully supports the administration position in the provisions of the bill. That does not mean that they would think every word in the House bill is correct, any more than we do.

Senator WILLIAMS. I had understood indirectly, not officially, that the Department of Commerce was concerned about certain features of this bill as it dealt with the shipping industry; is that correct?

Secretary DILLON. But that was covered in my statement yesterday and earlier this morning. We were concerned, too, but we never recommended that the shipping industry be included, except insofar as the companies would come under the provisions of the liquidation section, section 16.

I am not sure that they are included. But the law as it passed the House was unclear on this subject and, therefore, we have recommended that this be clarified. The situation in the shipping industry is such that under the financing arrangement under which all the ships have been financed by our own institutions, almost all income they will receive, 95 percent of it or 99 percent of it, goes to pay off over a period of years these loans to insurance companies.

If you took half of that money away, probably the loans would never be repaid because the ships would wear out before they would earn enough money to pay the loans. So this is a very big problem and we certainly do not want to upset these loan repayments, so we have recommended that provisions be put in to take care of it.

Senator WILLIAMS. And those recommendations are in line to overcome the previous Commerce objections then; is that it?

Secretary DILLON. They were not Commerce, they were our own. Nobody had to go to the Department of Commerce.

Senator WILLIAMS. I do not mean it that way, but they were the ones which Commerce were concerned about.

Secretary DILLON. It may well be.

Senator WILLIAMS. In connection with the withholding provisions, would there be any withholding on interest being paid on the World Bank bonds?

Secretary DILLON. It is not subject to withholding. It is an international institution.

Senator WILLIAMS. Yes; that is right.

Secretary DILLON. And not subject.

Senator WILLIAMS. Yes. Any outstanding bonds of the Export-Import Bank subject to withholding?

Secretary DILLON. The Export-Import Bank is an American institution, and to the extent it has bonds they would be subject to withholding.

Senator WILLIAMS. Yes.

World Bank bonds are guaranteed by the U.S. Government.

Secretary DILLON. They are also guaranteed by all the member governments.

Senator WILLIAMS. That is right. But if you and I were buying them we would rely largely upon the U.S. Government guarantee, I expect, but they are guaranteed with the Government's backing.

Secretary DILLON. It does not work quite that way, but there is an indirect guarantee under which the United States has agreed to put up funds, if necessary, to meet its bonds.

Senator WILLIAMS. We have a pledge to put up three to five billion or enough in the event of a default so that they can look to the U.S. Government for payment.

Secretary DILLON. As well as to other governments.

Senator WILLIAMS. But if the other governments do not come up with the money then, an individual who had bought those bonds could look to the U.S. Government for payment, could he not?

Secretary DILLON. He could look to the World Bank which, in turn, could look to the U.S. Government.

Senator WILLIAMS. And there is no withholding on that interest?

Secretary DILLON. No.

Senator WILLIAMS. Is there withholding on U.S. Government bonds that are owned by foreign governments? Would you withhold on those bonds?

Secretary DILLON. As the law presently stands, there is withholding on such bonds as are coupon bonds. Since there is no tax owed on the bonds, we have under consideration discussing in executive session an amendment which might remove them from the withholding, providing they are held for the full interest period.

It becomes impossible if they are bought in the middle and only half the interest would belong to a foreign government and half would belong to somebody else. You would have to withhold there.

Senator WILLIAMS. When you speak of the present law you mean under the provisions of the House bill?

Secretary DILLON. Yes; under the provisions of the House bill.

Senator WILLIAMS. Under the present provisions they would be withheld?

Secretary DILLON. That is right.

Senator WILLIAMS. Are you making recommendations that they be exempted?

Secretary DILLON. Only if they were held for a full interest payment period because if they were bought in between there would be just no way to file an exemption certificate.

Senator WILLIAMS. I understand when they are known to be owned by the foreign government. How does this bill propose to work on citizens of foreign countries?

Secretary DILLON. They presently have withholding of 30 percent, I think the rate is, sometimes reduced by treaty to a lower rate, but that has been the law for a long time.

Senator WILLIAMS. With coupon bonds?

Secretary DILLON. I think on bonds, on stocks, on everything.

Senator WILLIAMS. How do you withhold—I do not question your statement—but how do you withhold on a coupon bond with a foreign citizen today? How does that work?

Secretary DILLON. I assume the paying agent does it. We can give you a memorandum on that. I do not know the details.

Senator WILLIAMS. I did not think the banks required proof of citizenship—they are marked payable to the bearer; a coupon of the U.S. Government is a negotiable piece of paper, and you do not sign it. I am wondering how it would work. Maybe if we find out how it will work it may give us some answers on this present proposal.

Secretary DILLON. I will be glad to give you a memorandum. I know we do have withholding on foreign individuals, but how it works I am not sure.

Senator WILLIAMS. Are you sure there is withholding under existing law, not the bill, but under existing law on coupons for foreigners?

Secretary DILLON. With foreign individuals?

Senator WILLIAMS. Yes; on coupon bonds.

Secretary DILLON. I think so, but I will give you a memorandum on that.

Senator WILLIAMS. And you would continue to withhold on the citizens of foreign countries?

Secretary DILLON. Oh, certainly.

(The Treasury subsequently supplied the following for the record:)

OPERATION OF WITHHOLDING ON COUPON INTEREST RECEIVED BY NONRESIDENT ALIENS, ETC., UNDER EXISTING LAW

Withholding is required in the case of coupon and registered bond interest paid to nonresident aliens, nonresident partnerships, and nonresident foreign corporations. By regulation the tax is not required to be withheld on accrued interest paid by the buyer to a foreign seller in connection with the sale of bonds between interest dates, even though the interest is subject to tax.

Withholding on nonresidents is generally at a 30-percent rate. The general 30-percent rate has in many instances been modified by the regulations in accord with treaties with various foreign countries which change the ultimate tax rate or exempt certain payments entirely from tax.

The operations as set forth by regulations are as follows: When interest is payable by coupon held by nonresidents, an ownership certificate is submitted usually by nominees to the paying institution. This ownership certificate is Internal Revenue Form 1001 series. These forms state the owner of the underlying security.

On the basis of the ownership certificate, or the paying agent, or the withholding agent, pays the interest and withholds the tax applicable under the code or regulations which may apply.

Payers remit withheld funds once each year on March 15 when they file an annual return, form 1042.

Senator WILLIAMS. One of the witnesses who was testifying before the committee, I just forget who he was representing, but he made the point that under this bill it required that Americans who had investments abroad could be required to file information returns to the U.S. Government under penalty of \$1,000 fine or, perhaps, imprisonment. But, he said, in some instances it would be illegal for him to obtain that information in the countries in which they had the investment.

Could such a situation exist under this House bill?

Secretary DILLON. I am not aware of that exact situation. There were some technical amendments to the reporting provision that were

clearly required which I suggested in my statement yesterday. We obviously do not want to put an individual in a position where he is actually penalized for not doing something that is physically impossible for him to do, as where he does not know the facts.

Senator WILLIAMS. Perhaps that was not the intention, but this witness was so insistent that such was the case that under the bill he could be subject to a fine, I think he said, of \$1,000, and possible imprisonment, and he would be subject to a penalty under the laws of the foreign country if he did furnish it.

Secretary DILLON. I think that problem can be worked out.

Senator WILLIAMS. If I am not mistaken, it was the witness for Price Waterhouse.

Secretary DILLON. As I said, there were certain areas in that particular section that were not clear, and that need improvement, and I suggested a couple of them in my statement. There may be others, but I do not see any problem there that is a problem of substance.

Senator WILLIAMS. On this withholding, the suggestion has been made that the nuisance or the inconvenience in the withholding tax would fall largely on those who have larger incomes. I think you will agree with me that, without discussing the merits of it, it would be directly the opposite, would it not?

Secretary DILLON. That is would be what?

Senator WILLIAMS. The opposite. Those who have large incomes—we will take, for instance, a man who has a \$50,000 investment income. Under existing law he is required to file an estimated tax return and pay it quarterly.

Secretary DILLON. That is right.

Senator WILLIAMS. And, we will say his tax is \$16,000 per year. If this bill is passed, he will have 20 percent withheld, which will be \$10,000 withheld, and he will merely file a lower estimated tax return.

Secretary DILLON. That is right.

Senator WILLIAMS. So he, in effect, is not so much affected by the withholding provisions, that is, a man with a higher income, is that correct?

Secretary DILLON. I do not see how he is affected at all.

Senator WILLIAMS. The hardship would arise with those of low incomes, we will say, a couple have a \$3,000 income. They would owe little or no tax, but under the withholding they could be subject to \$700 withholding when, perhaps, they would only owe \$100 in taxes. Naturally they file no estimated return, so they would have to obtain refund, wouldn't they?

Secretary DILLON. By obtaining refunds quarterly, yes.

Senator WILLIAMS. Yes. So if there is hardship, the hardship would fall on those who have low incomes and low investments largely, would it not?

Secretary DILLON. I do not agree there is any hardship, so I cannot answer that question.

I believe I can answer by saying that those who would have to file refund returns are those with lower incomes.

Senator WILLIAMS. The ones who were in the larger brackets could, would not be affected so far as withholding.

Secretary DILLON. They would not have to file refunds because they would not be owed them.

Senator WILLIAMS. How many refund certificates do you estimate to be handled?

Secretary DILLON. A maximum of about 1 million, compared to 37 million that are presently handled under wage and salary withholding.

Senator WILLIAMS. Are there 37 million refunds under wage and salary now?

Secretary DILLON. That is right.

Senator WILLIAMS. Quarterly?

Secretary DILLON. No; that is all together, 37 million go out.

Senator WILLIAMS. Individuals?

Secretary DILLON. We figure there would be about 1 million of these all together.

Senator WILLIAMS. And you make refunds to 37 million wage earners?

Secretary DILLON. That is right.

Senator WILLIAMS. Are they made quarterly or annually?

Secretary DILLON. They are made annually. The extra amount is kept from the taxpayer so he has no use of it for a whole year. The average is \$150 a person, and I have heard no complaints about that.

Senator WILLIAMS. But on wages there is this difference, I think you will agree, that the individual can list with his employer the number of dependents that he has, and compute his tax liability on that basis, they do not always withhold the 18 percent. Sometimes it may be as low as 1 or 2 percent or 5 percent, depending on what is left; is that not true?

Secretary DILLON. That is true. But the net end result comes out that there is overwithholding averaging \$150 on 37 million people, which is by far more overwithholding on the average than there will be under this provision and the people who are overwithheld on wages and salaries object.

Senator WILLIAMS. I am not debating that point, but that still does not change the fact that with reference to withholding on dividends you do not take into consideration their number of dependents in withholding on wages.

Secretary DILLON. Well, their refund allowance is based on what their exemptions are, and that would include dependent exemptions.

Senator WILLIAMS. Under this bill you would allow an individual on his withholding, to file an exemption certificate. E bonds would be subject to withholding, would they not?

Secretary DILLON. When they are cashed.

Senator WILLIAMS. When they are cashed.

Secretary DILLON. That is right.

Senator WILLIAMS. And that would be on the full amount of interest that is accumulated even though it may have been over a period of 10 or 15 years prior?

Secretary DILLON. That is correct.

Senator WILLIAMS. An individual would not be permitted, as I understand it under this bill, to file exemption certificates on coupon bonds, is that correct?

Secretary DILLON. No. We have not made provision for that because the banks do not feel, and we think they are right, that this is workable because of the transfer of coupons in the middle of an interest payment period.



Senator WILLIAMS. Would there be withholding on all coupon bonds regardless of whether they were charitable organizations or otherwise?

Secretary DILLON. Presently that is what the House bill has.

Senator WILLIAMS. What is your recommendation?

Secretary DILLON. Well, whether they are charitable or not they still come under this same problem that if they have been bought or sold by the charity in the middle of the interest period, there just has to be withholding, so it is very difficult.

I think one thing we are trying to work out, is to see if there is any possibility to have an even more rapid refund proposal for coupon bonds owned by charities. We are working to see if it is possible, and if so it might alleviate the slight inconvenience that some of them may have.

Senator WILLIAMS. But under the provisions of the bill, and as your recommendations presently stand, there would be withholding of the full 20 percent on coupons regardless?

Secretary DILLON. That is right.

Senator WILLIAMS. Well, that was my understanding.

That is all.

Senator GORE. Mr. Secretary, I shall not inflict on you with any more questions at this late hour. I would like to say that, like Senator Williams, I am dubious about your recommendations yesterday that sections 13 and 16 not apply to Puerto Rico and other possessions.

I am advised by businessmen in whom I have confidence that Puerto Rico is now the site of large and indefensible tax avoidance, although it may not fall into the category of the classical tax-haven operation which we have described in other countries; nevertheless, with 80 percent of the corporations in Puerto Rico being organized as foreign corporations, with the very liberal and lax exemption certificate practice, and reorganization practice, this question must, of necessity be examined lest we make a Liechtenstein of one of our own possessions.

One other comment, if I may be pardoned: I have serious misgivings that the trade bill or that both the trade bill and this tax reform bill together will solve the balance-of-payments problem.

I still strongly feel that in some way we must require our citizens to conform their operations abroad to the interests of the United States. We are the only large sophisticated society that permits its citizens to invest abroad for their own personal benefit even when such may be contrary to the national interest. I think you will be talking to this committee some further on this subject.

Permit me to say, in closing, that you have demonstrated a perfectly remarkable grasp of the facts and the issues before this committee; you have demonstrated great patience, ability, and gentleness.

As acting chairman, speaking for the committee, I wish you a happy and joyous visit to Rome, but add further, I hope you take your lovely and charming wife with you.

The Chair submits for the record departmental reports received commenting on S. 2716 and S. 2666, which were discussed during the hearings by Senator Everett M. Dirksen, whose testimony appears on pages 1941-1948 in part 5 of the printed hearings.

(The reports on S. 2710 and S. 2600 follow:)

TREASURY DEPARTMENT,  
Washington, May 10, 1902.

HON. HARRY FLOOD BYRD,  
Chairman, Committee on Finance,  
U. S. Senate, Washington, D. C.

DEAR MR. CHAIRMAN: This is in response to a request for the views of this Department on S. 2710, introduced by Senator Dirksen, of Illinois, entitled "A bill to amend section 170 of the Internal Revenue Code of 1954 with respect to certain organizations for judicial reform." An identical bill, H. R. 10080, has been sponsored by Congressman Yates, of Illinois and has been referred to the Committee on Ways and Means for consideration.

S. 2710 would amend section 170(c)(1) of the Internal Revenue Code by enlarging the definition of a charitable contribution to include a contribution or gift to or for the use of any nonprofit organization created and operated exclusively to consider proposals for the reorganization of the judicial branch of Federal, State, or local governments and to provide information, make recommendations, and seek public support or opposition as to such proposals. The amendment would be effective for taxable years ending after the date of enactment of the bill.

Although the bill is cast in terms of a deduction for charitable contributions, it would permit the deduction of a special class of lobbying expenses; i. e., expenses for lobbying with respect to legislation aimed at reorganizing the judiciary. As you know, section 3 of the proposed Revenue Act of 1902, as it passed the House of Representatives, permits taxpayers engaged in business to deduct certain lobbying expenditures. Those include the cost of appearing before committees of Federal, State, or local legislative bodies, contacting individual legislators, transmitting legislative information between a taxpayer and an organization of which he is a member, and the portion of the dues paid by a member attributable to carrying on of such activities by the organization.

It is most significant that the House of Representatives restricted the scope of its lobbying provision to direct contacts with legislators and their committees and to direct communications between organizations and their members. The cost of lobbying efforts to reach the public, or segments thereof, was specifically excluded from the scope of the proposed new deduction. S. 2710, which is aimed primarily at appeals to the public, would, of course, not be in accord with the decision of the House of Representatives. Enactment of S. 2710 would represent a significant change in the law denying the deduction of lobbying expenses which has been in force since 1915. For all these years, the rules denying a deduction for lobbying expenses have placed the public funds of the Treasury in an essentially neutral position with respect to competing interests seeking to influence legislation. Enactment of S. 2710 would represent a serious opening wedge in this longstanding position of tax neutrality.

Those seeking court reform obviously believe that the public should be educated as to the necessity of reorganizing the judiciary along certain lines. However, others may feel quite as strongly that such reform is undesirable. In any event, no pressing need has been shown as to why the Federal Government should help finance the propaganda campaigns which might develop over this particular issue. If S. 2710 were to be enacted, what valid reasons could be advanced against the inevitable requests which would arise for extending deductibility to the lobbying costs of other "worthy" legislation? Controversies over labor and tax legislation, proposals for public power developments and general health programs, and transportation and reciprocal trade problems as well as over legislative apportionment, urban redevelopment, and criminal law reform might well seem as important as judicial reform to many.

For the foregoing reasons, the Treasury Department is opposed to S. 2710.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,  
Assistant Secretary.

TREASURY DEPARTMENT,  
Washington, May 16, 1962.

Hon. HARRY F. BYRD,  
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: This is in response to your request of January 16, 1962, for the Department's views on S. 2000 entitled "A bill to amend the Internal Revenue Code of 1954 so as to exclude from gross income gain realized from the sale of his principal residence by a taxpayer who has attained the age of 60 years."

S. 2000 would exclude from gross income any gain realized by a taxpayer from the disposition of his principal residence, after either the taxpayer or his spouse has attained the age of 60, whether the disposition is by sale or exchange or by involuntary conversion. In the case of property of which only a portion was used as a principal residence, only that part of the gain which is attributable to the disposition of such portion of the property would be excludable. The bill would apply to dispositions of property occurring after December 31, 1961, and to taxable years beginning after that date.

Under present law, gains from the sale of a personal residence are generally taxable. However, sections 1033 and 1034 of the Internal Revenue Code postpone the payment of tax on the gain from involuntary conversions or from the sale of a personal residence if the proceeds are reinvested within a specified period in similar property.

S. 2000 would provide complete tax exemption for all gains realized from the sale of a home by eligible taxpayers rather than deferment of tax as under present law, since the exclusion would apply without the requirement that the proceeds from the sale be reinvested in another home. While the Treasury Department is aware of the many difficult financial problems encountered by older taxpayers, it does not believe that such an exemption would be desirable. To exempt older people from all tax on gains realized on the sale of a residence would not only involve an estimated annual revenue loss of \$50 million to the Government but would also produce substantial tax inequities. It would provide more favorable tax treatment for older taxpayers who have realized gains from the sale of a home as compared with younger taxpayers with similar gains who would not be eligible for the special treatment. It would also result in substantial differences in tax treatment among older people themselves, depending on whether their gains are derived from the sale of a personal residence or other sources.

In effect, S. 2000 singles out for special treatment one particular type of asset on which older people realize capital gain. In addition to the sale of personal residences, older people at various times sell other assets such as, stock, bonds, or small business interests and the like. Individuals realizing gain on the sale of assets other than homes are likely to feel that the law treats them unfairly if other older individuals are exempted from tax on gains from the sale of personal residences and they are not given the same treatment for their gains. Moreover, claims would no doubt be made for granting similar tax-exempt privileges to groups other than older taxpayers; for example, to the blind and disabled. As a result, the bill would create a strong precedent for extending very costly similar tax exemptions to gains realized by taxpayers of all ages from the sale of a wide variety of assets.

S. 2000 would also grant the greatest tax benefits to those older people whose financial position has been improved by large gains from the sale of a personal residence. The bill would grant little or no relief to older people with modest incomes who have only small gain from the sale of a personal residence or no gain at all from such sources. As a result some people 60 and over would be exempt from tax on certain gains while other individuals with smaller financial resources and smaller income would be required to pay tax on their gains.

S. 2000 would also establish an important precedent as to the age when a taxpayer should be treated as an older person entitled to special tax privileges. At present 65 is the age when tax provisions designed to benefit older persons begin to operate. This age limit is geared to the generally accepted retirement age in this country. The social security laws and many pension plans set age 65 as the earliest age for the payment of full benefits to primary beneficiaries. If this precedent to provide special tax relief on the basis of age to individuals under the age of 65 were followed in other provisions of the code, it would have very serious revenue consequences.

In evaluating the desirability of granting tax relief to older persons with gains from the sale of a personal residence, it is important to note that present law

already gives substantial special tax treatment to individuals who have reached the age of 65. Social security and railroad retirement benefits are entirely exempt from tax. Individuals of 65 years or more are entitled to a double personal exemption of \$1,200. They may benefit from the tax credit for retirement income provided by the 1954 Revenue Code. This generally allows eligible retired people who have reached the age of 65 to take a credit against their tax liability at the 20-percent first bracket rate on up to \$1,200 of retirement income, including pensions, annuities, interest, rents, and dividends. People of 65 and over are entitled to take medical expense deductions without regard to the limitation of such deductions to medical expenses in excess of 3 percent of adjusted gross income which generally applies to other taxpayers. As a result of the present special provisions, people who have reached the age of 65 may receive considerable amounts of income without incurring tax liability. For example, a husband and wife both over the age of 65 who are eligible under these special relief provisions and receive their income from dividends may now get as much as \$6,100 of income without payment of tax if they take the standard deduction of 10 percent of adjusted gross income.

Moreover, the capital gains provisions of the code, which generally apply on the disposition of a residence where the tax deferral rule is not applicable, already involve a reduced rate of tax. Generally speaking, half of the capital gain is excluded and the effective rate of tax in no case can exceed 25 percent of the gain. For persons in the lower income brackets, the effective tax on even a substantial gain would generally not exceed 10 or 11 percent.

In view of these considerations the Treasury is opposed to the adoption of S. 2666. The Department is now studying the whole problem of the tax treatment of capital gains and losses, including those arising from sale of a personal residence, as part of our comprehensive review of the tax structure. The Treasury believes that legislation involving broad issues such as those involved in this bill should be deferred and considered in the context of the major program of tax reform which the President intends to submit to the Congress later this year.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,  
*Assistant Secretary.*

---

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington, D.C., May 10, 1962.

HON. HARRY F. BYRD,  
*Chairman, Committee on Finance,  
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in response to your letter of January 10, 1962, requesting the views of the Bureau of the Budget on S. 2666, a bill to amend the Internal Revenue Code of 1954 so as to exclude from gross income gain realized from the sale of his principal residence by a taxpayer who has attained the age of 60 years.

The Treasury Department, in a report being made to your committee on this bill, opposes its enactment for the reasons stated therein.

The Bureau of the Budget concurs with the views contained in that report and opposes the enactment of S. 2666.

Sincerely yours,

PHILLIP S. HUGHES,  
*Assistant Director for Legislative Reference.*

Senator GORE. This concludes the hearings on H.R. 10650.

(Whereupon, at 5:45 p.m., the committee adjourned.)

(The following statement by Senator Harry F. Byrd, Democrat, of Virginia, relating to sections 2 and 19 of H.R. 10650 is made a part of the record:)

STATEMENT BY SENATOR HARRY F. BYRD, DEMOCRAT, OF VIRGINIA, PREPARED FOR DELIVERY ON THE FLOOR OF THE SENATE, MONDAY, MAY 21, 1962

I have the honor of being chairman of the Senate Finance Committee. In this position I usually refrain from announcing my position on legislation pending

in the committee until the committee has acted. I am now constrained by current circumstances and long experience with Federal tax legislation to make this statement at this time; and I do so in my own right as an individual Senator from Virginia.

I shall oppose administration proposals in the pending tax bill to withhold 20 percent in personal income taxes on interest and dividends, and to give a 7 or 8 percent tax credit to segments of business for investment in new machinery and equipment.

I have reached this firm position with respect to these two provisions in the bill after fullest consideration of views expressed by witnesses in exhaustive hearings, and those set forth in thousands of communications from the general public.

I have given closest possible study to statements in behalf of the administration's recommendations including those by the President in his press conference of May 9, and those made by the Secretary of the Treasury before the Finance Committee and elsewhere.

In addition, I have culled on my own experience, and knowledge of existing authority and facilities which had better be fully employed to curb tax evasion and revise depreciation credit before we resort to the withholding and tax credit legislation now proposed.

Members of Congress have been placed under tremendous pressure by representatives of the administration pressing for enactment of these proposals, and by citizens throughout the Nation overwhelmingly urging their rejection.

The hearings on the bill—which started April 2 and continued until May 11—have now been concluded. And at this point, under circumstances outlined, I am making this statement at this length to state my individual position with respect to the withholding and tax credit provisions in the bill, and describe in some detail the consideration leading to them.

Generally, the reasons for the conclusions I have reached may be summarized in a measure, and this I have attempted to do. But in view of the extraordinary interest demonstrated with respect to these two proposals, I shall include also additional detail for further consideration if it is desired by those who may be interested in this legislation.

I oppose enactment of the withholding proposal at this time for numerous reasons including:

1. Withholding taxes on interest and dividends cannot be compared with withholding taxes on salaries and wages; its administration would be terribly complex, if not impracticable and unworkable.

2. It would, by its inherent deficiencies, overtax people for extended periods, and impose hardship or inconvenience not only on taxpaying citizens but also on institutions and businesses used by the Government to collect the taxes.

3. Respect for our tax system must be maintained. It is necessarily complex enough. Unnecessary confusion must be avoided. The agitating characteristics of this proposal are already clear from public reaction. Tax evasion cannot be condoned, but this withholding proposal should be enacted only as a last resort.

4. An alternative is available, and it should first be given full trial. The Internal Revenue Service is now assigning numbers to taxpayers to eliminate identification difficulties, and at the same time it is installing computers to show currently what taxpayers owe the Government and vice versa. This combination should and will provide information for effective curtailment of tax evasion.

When the so-called identifying numbers bill was presented to the Senate by the Senator from Virginia and passed late on the night that Congress adjourned last September, Treasury officials advised me that the following statement could be made with accuracy on the floor of the Senate:

"This would be the biggest loophole closing bill in history; that it would increase Federal revenue by \$5 billion; and that when used in the computers, those avoiding taxes could be identified and compelled to pay."

In response to questions during his testimony on the pending bill, Secretary of the Treasury Douglas Dillon, on May 10, confirmed the fact that:

With identifying numbers and the computer systems, the Internal Revenue Service could obtain information necessary to levy proper taxes on interest and dividends, and with that information the Government's remaining job was to

collect the taxes. Secretary Dillon's only substantial reservation was that additional agents would be needed.

I am convinced that in the interest of good government the numbers-computer systems should be thoroughly tried before we resort to the administration's plan for withholding taxes on interest and dividends, which is certain to be accompanied by widespread confusion and considerable hardship.

If there is need to have more complete reporting--by banks and businesses--of information on income from interest and dividends, and heavier penalties for tax avoidance in these areas, I shall offer amendments providing for both.

Under terms of the pending bill, this withholding provision would not be effective until January 1, 1965. The complexities involved make it doubtful as to whether this withholding plan could be put into operation before 1964. The Secretary of the Treasury has testified that the numbers-computer systems would be in full operation during 1965-66; and in my judgment, if the effort were made, they could be in effective operation by 1964.

If, after reasonable trial in full operation, it is found that the numbers-computer systems do not close the loophole through which taxes on interest and dividends are being evaded, avoided, or overlooked, withholding can be adopted. But the numbers-computer systems should have a thorough trial.

I oppose enactment of the tax-credit proposal in the pending bill also for numerous reasons, including the facts that--

1. It is wrong in principle. It is in the nature of a Government payment before the fact instead of a credit for an accomplished fact.

2. It is a subsidy in the nature of a windfall to be given to businesses which comply with a Government policy.

3. It is discriminatory in its application among various businesses, even among those similar in kind. Incentive is a stated purpose of the proposal, but it would be retroactive to last January 1, and it is difficult to understand how the provisions would be an incentive for investments made before it is enacted. It would be a bonanza for certain corporations which could reach \$600 million.

4. An alternative is available. The Government has the authority, and belatedly is now taking action to modernize internal revenue regulations to provide realistic depreciation credit for plant and equipment.

These observations are expanded, and others are set forth, in the following sections of this statement.

#### WITHHOLDING ON DIVIDENDS AND INTEREST

All taxpayers should bear their fair share of the tax burden. Over the years we have searched for feasible means of withholding on interest and dividends. I had hoped the pending administration proposal would meet the difficulties. This has not been done, and I have concluded that the legislation should not be adopted at this time.

My present view is attributable primarily to two facts. First, the Treasury Department has not come up with a workable system of withholding. The proposal neither removes the hardships for the small shareholder or depositor who owes little or no tax, nor is it a workable system for the banks and corporations paying the interest and dividends. Second, I am convinced that the Treasury has not as yet made full use of the new social security numbering bill we passed last year nor automatic data processing, which is so closely interrelated with the numbering bill. As I point out, I believe that with an extension of the application of information returns, there is a good possibility of collecting the tax on the presently nonreported dividends and interest without imposing the burdens apparently in a withholding system.

The President in his recent news conference has said that this is not a new tax and, of course, it is not--but it would be a new way of collecting it. And unless refunds are promptly made it could result in a tax increase. The President said that it will not take money unjustly from honest taxpayers--but it will unless they have no tax liability and file exemption certificates. (If they have tax liability and can file quarterly refund claims, they are deprived of the use of their own money for anywhere from 1 to 4 months.) He has said that it would not create a mountain of redtape--but I believe he will change his mind when the Internal Revenue Service undertakes the job of processing 8 million or more exemption certificates and millions of quarterly refunds. The President said it will not harm the elderly, the widows and orphans, and others of low

income but these are the very groups which owe little or no tax and must choose between the exemption and refund provisions. Even if they choose correctly, they are likely to be deprived of the use of their income for a time. Unfortunately, they are likely also to be the ones who through lack of information will not get back what the Government justly owes them.

#### *Impracticable or uncorkable*

Withholding on dividends and interest has been represented to us as being a simple system for both the taxpayer and the payor of dividends or interest. We have been told that the problems of the aged, the children, and the others who owe little or no tax have been provided for, with the result that there are no hardships under the bill. We also have been told that wage and salary earners are withheld upon and therefore why shouldn't withholding also apply for those who receive dividends and interest.

The very substantial opposition which individuals throughout the country have expressed withholding on dividends and interest, through thousands upon thousands of letters to their Congressmen and Senators, should be ample evidence that there must be something wrong with the administration proposal. The testimony before the Senate Finance Committee has convinced me that what is wrong with the proposal is that it is neither simple in operation nor free of substantial hardship for broad groups of taxpayers. I also am convinced that the system proposed contains many avoidance possibilities which have been glossed over by the administration.

The exemption certificates provided under the bill have been held out as being the major means by which hardship is removed under the bill. These exemption certificates, however, may be filed only by those who have no tax liability whatsoever. This means that exemption certificates may be filed by most youngsters and also by the elderly who had no tax liability. However, many others, both in the elderly category and among younger people will be faced with substantial hardship under the bill because of overwithholding on dividends and interest. Even those who can file exemption certificates, however (unless they are under age 18) must state under penalty of perjury, that they expect to owe no tax for the coming year. Won't many conscientious persons who either in fact turn out to owe no tax, or little tax, feel that they cannot sign such a statement before the year even commences and therefore won't they effectively be deprived of the use of the exemption certificate?

For individuals expecting to have any tax liability, quarterly claims for refunds must be filed if they expect to have the overwithheld amounts returned during the year in which the withholding occurs. Those who file these quarterly claims can expect a delay of at least 3 or 4 weeks before they receive back the overwithheld amounts, and may have to wait as much as 3 or 4 months before the withheld amounts are returned. This deprives them of the use of these funds as living expenses or as sources of investment during the interval. I believe it is this aspect of the proposed withholding system which makes so many individuals consider that withholding on dividends and interest in effect constitutes a new tax.

This quarterly refund claim which must be filed (or verified) by the individual four times a year is far from a simple calculation. The complexities of this are shown on page 91 of the House committee report on this tax bill. However, in addition to the 10 items listed in that calculation, the taxpayer must list in detail the source of each separate amount of dividend or interest income which he receives. Finally, he must also list all of the same material all over again in a tax return filed at the end of the year, in order to receive his refund for the fourth quarter. Although the taxpayer may have to fill out the refund claim only once and then merely verify the figures sent to him in the two subsequent quarters, this will only be true if his dividend or interest income and other income remains exactly as anticipated. Otherwise, new calculations must be made each quarter.

It should also be noted that the quarterly refund provided by the bill, as passed by the House of Representatives, does not allow for all cases under which overwithholding may arise. It does not, for example, make any allowance for the \$50 dividend exclusion (\$100 exclusion on many joint returns), for the 4-percent dividend credit, and for the excess of itemized deductions over a standard deduction. Moreover, no quarterly refund at all may be filed by a single individual with more than \$5,000 of gross income or a married couple with more than \$10,000 of gross income.

While the exemption certificates and quarterly refunds do not resolve the hardship problems for the shareholder or depositor, they nevertheless will present many compliance problems for the corporate and bank payers of the dividends and interest. The corporations and banks will have to maintain two files of stockholders or depositors. In the case of stock, the corporation must also be prepared to shift stockholdings back and forth between these two files as it is purchased and sold or as exemption certificates are issued. Moreover, special problems will arise where stock is sold just before a dividend date by someone who has filed an exemption certificate to someone who has not, if the stock certificate has not actually been delivered to the corporation before the dividend date. Moreover, in order to use exemption certificates at all, taxpayers will have to forego the convenience of leaving stock in their brokers' names.

Although not touched upon by the Treasury Department in its explanation of withholding before the Finance Committee, there also will be serious administrative problems for the Internal Revenue Service as a result of the use of exemption certificates and quarterly refunds. These, if not policed very closely by the Service, can lead to substantial tax evasion. There is no assurance, for example, that only those who "reasonably expect no tax liability" will file exemption certificates unless these certificates, representing at least 8 million taxpayers, are checked by the Internal Revenue Service. Moreover, these will not be easy to check because many of them will represent persons not required to file tax returns so there frequently will be no returns to match them against.

Similarly, since the individual when he files a quarterly refund need submit no proof of the receipt of dividend or interest payments, here too there is ample opportunity for tax evasion and fraud as well as unintentional mistakes. These also must be checked in detail and compared with the amount shown on final returns if the purpose of the legislation is to be fully accomplished. In fact, it is entirely possible that some taxpayers might file exemption certificates, file quarterly refund claims, and still claim refunds on their final returns at the end of the year, all with respect to the same dividend or interest payment or with respect to no dividend or interest payment at all. While the Internal Revenue Service through simple auditing may be able to control this form of tax evasion and unintentional errors, I believe it will require no small enforcement effort.

Another source of confusion under the Treasury proposal is the so-called "gross-up" procedure the Service intends to follow. We are told that it is possible to do away with the necessity of giving receipts to the interest or dividend recipients under the proposal because taxpayers can "gross-up" their dividends and interest on their tax returns. Although the arithmetic of "gross-up" may be correct, it is likely to lead to many problems. Taxpayers will almost certainly get mixed up between the interest and dividend payments which they are required to "gross-up" and those which they are not, with the result that this will constitute a substantial source of errors on tax returns.

This omission of some forms of interest from a withholding system not only will lead to confusion on the part of the taxpayers as to how to treat interest on their tax returns but will also create favored categories of investment—those not subject to withholding. Under the bill withholding does not apply, for example, to interest on mortgages, interest on debt held by individuals, and interest paid in the form of discounts. This means that such forms of investment will become more attractive than other forms of investment which are subject to withholding, such as bank account interest and Government bonds.

I have dealt here only with the problems of withholding on dividends and interest for individuals. Many more are involved in setting up a withholding system for dividend and interest payments going to corporations. This clearly is useless since the withheld amounts are immediately refunded to the corporations without regard to their tax liability. Similarly, problems are raised in connection with the application of the dividend and interest withholding system in the case of trusts, partnership investment clubs, mutual funds, etc.

#### *Comparison with wages and salaries*

Much has been said to the effect that wages and salaries are subject to withholding and therefore why shouldn't dividend and interest income be subject to withholding. If a workable system could be devised for dividends and interest, I would certainly agree with this conclusion. However, as indicated above, I do not believe the Treasury or the House of Representatives has been able to solve the difficult problems of withholding on dividends and interest.

The problems in connection with withholding on dividends and interest are much greater than those faced in connection with wage and salary withholding.



Most employees have only one employer (as contrasted with many sources of dividend and interest income), and because of their close association with their employers, it is possible for them to file employees' withholding exemption certificates with their employers. This makes allowance for the number of their exemptions, as well as the 10 percent standard deduction. As a result, withholding in the case of wages and salary in actual practice may vary from zero up to 18 percent, but in no case does it reach the 20 percent rate which would apply across the board under the administration's proposals for dividends and interest. The pending proposal, therefore, is much more likely to result in overwithholding in the case of dividends and interest than present law in the case of wage and salary withholding. Despite this there is overwithholding on wages and salaries on a very large number of returns at the present time.

This suggests even more overwithholding in connection with dividends and interest. Moreover, while much of the overwithholding in the case of wages and salaries is relatively small, the overwithholding on dividends and interest could be expected to be quite large on a per return basis. For example, for a retired couple, with both husband and wife over age 65 and receiving half of their income from dividends and half from interest, there may be some overwithholding for income levels up to \$20,000. The overwithholding on such a couple at the \$5,000 income level would equal 10 percent of the income after tax, all of which would have to be recovered by quarterly refunds.

#### *Alternative to withholding*

I want to make it clear that in my view everyone should pay every dollar of tax they owe. I am not in any sense of the word justifying the underreporting of income in the case of dividends and interest. However, because of what I believe is the impracticability of the withholding legislation proposed by the administration, I do not believe that legislation of this type should be enacted until every other means of collecting that tax has been exhausted.

With the development of computers for automatic data processing, I believe the use of information returns to collect the tax on dividends and interest should be given a real trial before going to the extreme of adopting a complicated withholding system for dividends and interest. The Treasury Department has intimated that an information return system would be more complicated for the dividend and interest payors than withholding, but in my opinion this is adequately rebutted by the testimony before the Finance Committee. Most payors who testified expressed a decided preference for the extension of the information returns over the initiation of a withholding system.

It must be remembered that withholding of 20 percent would not determine the tax liability of any payee. Only the filing of the payee's tax return, and its audit by the Service, would determine his liability. The tax he owes would always be less or more than that amount, depending upon his other income, personal exemptions, deductions, and credits. Without adequate information, such as is made available for salaries and wages, the income tax system cannot operate as it is intended. We must bend every effort to improvement of the informational reporting system for dividends, interest, and other types of income, as the account number legislation and the data processing machines are designed to do.

Information returns in the case of dividends are already required down to a level of annual payments of \$10 per shareholder. At present, interest payments are reported only when they amount to \$600 or more. Information could be required down to the same \$10 level presently applicable in the case of dividends.

Likewise, a longer statute of limitations could be provided with respect to any omitted income including dividends or interest. Under present laws the general statute of limitations during which a return may be examined is 3 years after the return is filed, although where 25 percent or more is omitted from gross income there presently is a 6-year period of limitation. This 6-year period of limitation could be made to apply with respect to any single source of income which is entirely omitted from a taxpayer's return.

#### *Use of automatic data processing*

I believe that the matching by the Government of information returns against tax returns will provide essentially the same check on interest and dividend reporting as a withholding system, with one exception: The information returns will be more effective in that they will indicate the missing tax above the first bracket rate. The 20-percent withholding system proposed in the pending bill does not provide for receipts, and therefore would not point out this missing income above the amount withheld.

As the automatic data processing facilities become effective it should be possible to match a large proportion of the information returns against tax returns. A statement by Internal Revenue Commissioner Mortimer Caplin before the New York State Bar Association on January 25 of this year indicates that by 1965 all of the nine regions of the Internal Revenue Service in the country will be affected by automatic data processing. He said by that time:

"We will be well on our way to completing our master taxpayer file of some 78 million consolidated tax accounts recorded on 500 miles of magnetic tape."

"As a result, with the longer period of limitations which I have suggested for omitted sources of income, it should be possible to use the automatic data processing system to match the information returns and tax returns, even for what will then be the back years 1962 and 1963. While this matching is a large job, it should be well within the realm of the possible when we remember that, according to Commissioner Caplin, the machines:

"Reading at a speed of over  $6\frac{1}{2}$  million letters or numbers a minute \* \* \* will reveal any discrepancies or unusual characteristics suggestive of the need for further examination, and will then list this information at the remarkably high print-out speed of over 600 lines per minute."

The Treasury has emphasized that although automatic data processing, through the matching of information returns and tax returns, discloses discrepancies, there still remains the job of collecting the taxes. However, I believe the Treasury is underrating their new system in not pointing out the job that automatic data processing can also do in aiding in the collecting of taxes. For example, Assistant Secretary Surrey, in an article in the January issue of *Tax Review* of New York University in commenting on automatic data processing and tax administration, states:

"Also, separate tapes, representing bills or refunds, can be produced as an output of this same operation, to be followed in turn by high-speed printing of appropriate communications to taxpayers. To go further, another part of the same program can be designed to identify taxpayers accounts requiring other forms of action, such as issuance of delinquency notices, the notification to audit personnel of possible need to examine the return, the preparation of taxpayers registers of various kinds, and the accumulation of specific information for management needs."

Assistant Secretary Surrey, in the same article, continues:

"The maintenance of a consolidated account under an automatic data processing system provides the means for issuing net bills covering liabilities for multiple taxes \* \* \* billing can be prompt and accurate. Furthermore, the machine-prepared bill permits more detailed and explicit information for the taxpayer than is economically feasible under a nonmechanical system."

I recognize that to do a thorough job of collecting the tax attributable to dividend and interest income may require some increase in personnel for the Internal Revenue Service. However, since it is possible to use automatic data processing for billing and carrying on initial correspondence with taxpayers, this increase in personnel need not be as large as it is sometimes assumed. Moreover, the alternative, namely, the withholding system proposed by the administration, would also be costly. This system attempts to collect the tax not only on dividend and interest payments above \$10 but also the tax on smaller amounts as well. The withholding at 20 percent even on \$10 is only \$2, only slightly above the \$1 minimum used in tax computations on the tax return. I believe it is also clear that if extensive tax evasion and mistakes are to be prevented, a sizable auditing group must be assigned to validating the proposed exemption certificates and quarterly refund systems. This is true even though the amounts involved in many cases will be very small. Also, the payor's costs for a withholding system involving exemption certificates cannot be ignored. This cost will, of course, through the deduction of business expenses, be reflected in a decrease in governmental revenues.

#### *Conclusion on withholding*

I believe that the numbers-computer systems such as outlined here should be given a full and complete trial before further consideration is given to a withholding system on interest and dividends. I base this primarily on the hardship and confusion that a withholding system on dividends and interest will cause for those who either have no tax liability, or only a relatively small tax liability which in any case is likely to be offset at least in part by excess withholding on wages and salaries.

Our tax system year by year is getting more and more complicated, and the harassment of the taxpayer is increasing almost with each change made. Respect for our tax system must be maintained. Unnecessary complexities and burdens must be avoided. The withholding system on dividends and interest proposed by the administration would be a substantial step to the contrary.

Withholding on interest and dividends has been before the Senate on four previous occasions—in 1942, 1950, 1951, and 1960. It has been overwhelmingly defeated each time because of its inherent complexities. The present proposal occupies some 46 pages in the pending bill, filled with technicalities and exceptions. Having waited through this long period of time, spanning much of my service in the Senate, I have concluded that we should give the systems I have outlined, using the account number legislation and the new electronic machines, an opportunity to cope with the problem before adopting a proposal which the Senate has for obvious reasons so often rejected.

#### INVESTMENT CREDIT

I must strongly oppose the investment credit proposal in the pending bill.

The Treasury estimates that the version of the credit which passed the House (7 percent) will result in an annual revenue loss of about \$1.2 billion; but the administration prefers an 8-percent credit which the Treasury estimates will result in an annual revenue loss of nearly \$1.4 billion.

Under present conditions—when we are faced with the prospect of a deficit in the current year of \$7 to \$10 billion and the likelihood of another deficit of \$3 to \$4 billion next year—I could only view it as an act of fiscal irresponsibility were we to adopt a \$1.4 billion investment credit, and this I predict would be merely the beginning. It does not include credit on buildings which could be expected to come later.

We are all concerned about the rate of growth of investment in capital in the American economy. However, I believe that the investment credit is discriminatory, wrong in principle, and would do great harm to our tax structure. In addition, I believe it would be ineffective in achieving the growth in investment sought and is not needed under present conditions.

#### *Wrong in principle and discriminatory*

I view the investment credit as a subsidy—as a payment, through a special tax reduction, for taking a particular action sought by the Government. When tax reductions are possible, I believe they should take the form of removing restraints. In this manner we can obtain a more realistic and natural growth in investments, one which matches investments with the demands and needs of the economy rather than with benefits derived from an arbitrary tax reduction.

That the investment credit is wrong in principle was recognized by the great majority of the witnesses before the Senate Finance Committee. Fully two-thirds of the witnesses referring to the credit in their appearances before the committee opposed it.

It is difficult for me to see why the administration so strongly advocates this investment credit when the leaders of industry, labor and farmers specifically oppose it.

Stanley H. Ruttenberg, director of research of the AFL-CIO, with reference to the investment credit, urged the committee to “ \* \* \* delete this provision from the bill, because we think it is a multibillion-dollar windfall that will not really contribute anything to our national goals and will not relieve our balance-of-payments problem as it is claimed to be.”

Mr. Walter Slowinski, appearing on behalf of the chamber of commerce with respect to the investment credit, said:

“The chamber again recommends against the adoption of this novel and untried preferential tax credit subsidy for business. It is also unnecessarily complex and it will be difficult to administer \* \* \*.”

Mr. Harold H. Scaff, chairman, Tax Committee, National Association of Manufacturers, said of the investment credit:

“It would simply provide reduction in effective tax rates for taxpayers who use their income, or other funds, as the Government thinks is best for the economy at a particular time.

“There has been a tendency to promote and discuss the investment tax credit apart from the price which it would exact in terms of other changes in the tax law. Even without the exaction of such a price, we would oppose the credit for the reasons set forth in the appendix attached hereto. Very simply, we believe

that tax reductions should be afforded by direct means. We would take this position even if, in our opinion, all of the other provisions of H.R. 10850 constituted sound tax policy."

Mr. Charles B. Shuman, president of the American Farm Bureau Federation, indicated that the Farm Bureau opposed the investment credit. He stated:

"These provisions are both unsound and likely to have a number of undesirable effects. It would be far better to liberalize the treatment of depreciation and to work toward a general reduction in income tax rates.

"The proposed investment credit is a selective form of tax relief, in reality a subsidy \* \* \*. The result would be to give some taxpayers a competitive advantage at the expense of others."

Although the farmers' union did not testify before the Finance Committee, a communication signed by James G. Patton, president, National Farmers' Union, inserted in the Congressional Record on March 20, 1962 (p. 4084) states as follows: " \* \* \* urge your influence to delete provision giving huge private corporations operating at less than full capacity over \$1½ billion and private electrical power monopoly over \$100 million in tax subsidies which would result in the flight of capital overseas and further aggravate the dollar crisis."

The investment credit is wrong in principle because it, coupled with depreciation, returns to the investor more than 100 percent of what he paid for an asset. In other words, the investment credit allowed is over and above regular depreciation. Thus, it represents a gift, or subsidy, to a selected group of taxpayers.

The investment credit is also wrong in principle because it is discriminatory. For example, the United States Steel Corp. advises me that their maximum credit for 1962 would be no more than \$5 or \$6 million, while the American Telephone & Telegraph Co., on a 7-percent rate, would receive in 1 year \$350 million. The very fact that the investment credit selects those who make investments as the recipients of the special tax reduction means that it discriminates against those who for any reason cannot make the investments. This means, for example, that those who made substantial investments last year or the year before, and therefore cannot make investments in 1962 or 1963, are discriminated against. This is also true of those who cannot obtain the funds to make investments, and of those who cannot afford to make investments because of already existing excess capacity in their industry. A second major type of discrimination exists in the case of those whose income is relatively small in the current year, because the investment credit allowed under the House bill or the administration proposal is limited to 25 or 50 percent of tax liability in excess of \$25,000. A third type of discrimination under the bill exists in the case of certain types of investments. For example, the investment credit is not available for buildings or structural components, for increase in inventory, or for increases in accounts receivable, or under the administration proposal for investments in public utilities. (The House bill provided a 4-percent tax credit for public utilities.)

Revisions made in our revenue structure must not be allowed to create new discrimination and artificial distinctions among taxpayers. Instead, our attention should be directed toward lessening, rather than increasing, such factors.

#### *Ineffective and questionable*

Serious questions arise as to the efficiency of a device designed to stimulate new investments which indiscriminately awards tax rebates for all new investments, even though most of them would be made without investment credit. Moreover, if the purpose of this credit is to stimulate investment, I cannot see why the administration would make the provision retroactive to the first of this year. This retroactive feature could produce a windfall of as much as \$600 million over the period from January 1962 to the date the bill could become effective. There has been too much uncertainty as to the passage of this measure for anyone to be sure the investment credit would apply to investments made to date. The retroactive application of the provision therefore is completely wasted as far as any stimulative effect is concerned.

Another factor apparently overlooked by the administration is that investments made now will not be eligible for the investment credit in many cases for a period of 2 to 3 years. Mr. R. C. Tyson, chairman of the Finance Committee of the United States Steel Corp., for example, indicated in a letter to me that in the case of the steel industry a period from 24 to 30 months on the average will elapse between the date the project is begun and the date the expenditures are eligible for the credit.

The new McGraw-Hill survey asked industry how much it would increase investment plans if an investment credit were to be provided. The answer was that the credit would boost 1962 investments by only 1 percent, or \$300 million. This is indicative of the relative ineffectiveness of the investment credit as a stimulant for increased investment.

Many of the witnesses who appeared before the Finance Committee also doubted the effectiveness of the investment credit. For example, Augustus W. Kelley, representing the Proprietary Association said:

"The theory of the tax incentive in our opinion is based on the false premise that business investments are motivated substantially by tax considerations. In our industry, and we believe it is typical of others, the decision whether or not to invest in new machinery and equipment is based primarily on pure business consideration. Simply stated, we are not going to spend \$1 just because the Government gives us 7 cents."

Mr. Otis H. Ellis, speaking for the National Jobbers Council, said:

"This tax credit will not be enough to induce a single jobber to buy one item more than what he would otherwise have purchased."

The McGraw-Hill survey, already referred to, anticipates that even without the investment credit, business investments in plant and equipment this year are expected to amount to \$38 billion, or \$1 billion above the previous record set in 1957. This is \$3.5 billion, or 11 percent, more than was spent last year. Moreover, the survey indicates that existing plans point to a high level of investment for the period 1964-65.

This anticipated rise in business investments, coupled with the fact that the Secretary of the Treasury has already announced firm Treasury plans to substantially revise allowable depreciation schedules under Bulletin F, in my view indicates that this is not the time for still further so-called aids to business investment. The depreciation provision alone, according to testimony of the Secretary of the Treasury (May 10-11 before the Finance Committee) is likely to result in a revenue loss of \$1.2 billion. I cannot believe that we should add another \$1.4 billion to this without first seeing the effect of the depreciation revision on investments.

